STATE OF IDAHO
OFFICE OF THE STATE CONTROLLER

STATEWIDE ADMINISTRATIVE AND FINANCIAL MANAGEMENT CONTROL SYSTEM
(Internal Control Policies)

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WHAT IS INTERNAL CONTROL?

Internal control is a management <u>process</u> for keeping an entity (agency, division, department, program, or college) on course in achieving its organizational objectives. A *management control system*, including comprehensive internal controls, should provide reasonable assurance entity objectives are being met. These objectives fall into the following three separate but related categories:

1. Effective and efficient operations
2. Responsible use of public funds
3. Compliance with applicable laws, rules, and regulations

To use a corporate analogy, Idaho taxpayers are "shareholders" of a highly diversified holding company. The State Legislature is the "Board of Directors," and the Governor is the "Chief Executive Officer." Each agency director is "Chief Operating Officer" of one of the "wholly-owned subsidiary companies" and reports to the Board through the Governor.

A management control system helps employees, supervisors, agency directors, the Governor, legislators, and the public have more confidence the entity of Idaho, with all its "subsidiaries," is achieving its stated objectives. Internal controls help ensure reliable financial reporting systems are in place and the state organization is in compliance with the laws, rules, and regulations controlling its activities.

If an entity builds the components of a management control system into its planning efforts as well as its daily activities, its members are more likely to avoid unnecessary costs; make quick responses as needs arise; and adapt to decreasing resources and changing political and economic climates. The five components of good internal controls within a management control system are as follows:

1. *Control Environment* - The control environment sets the tone of an organization, influencing the control consciousness of its people; and is the foundation for all other components of internal control, providing discipline and structure. Control environment factors include the integrity, ethical values, and competence of the entity's people; management's philosophy and operating style; the way management assigns authority and responsibility; the way management

organizes and develops its people; and the attention and direction provided by the board of directors.

2.   *Risk Assessment* - Every entity faces a variety of risks from external and internal sources, all of which must be assessed. A precondition to risk assessment is establishment of objectives, linked at different levels and internally consistent. Risk assessment is the identification and analysis of relevant risks to achieving the objectives and forms a basis for determining how the risks should be managed. Because economic, industry, regulatory, and operating conditions will continue to change, mechanisms are needed to identify and deal with the special risks associated with change.

3.   *Control Activities* - Control activities are the internal control policies and procedures to help ensure management directives are carried out. They help ensure necessary actions are taken to address risks to achieving the entity's objectives. Control activities occur throughout the organization, at all levels and in all functions. They include a range of activities as diverse as approvals, authorizations, verifications, reconciliations, review of operating performance, security of assets, and segregation of duties.

4.   *Information and Communication* - Pertinent information must be identified, captured, and communicated in a form and time frame that enables people to carry out their responsibilities. Information systems produce reports containing operational, financial, and compliance-related information, making it possible to run and control the entity. Information systems deal not only with internally generated data, but also with information about external events, activities, and conditions necessary to both informed business decision-making and external reporting. Effective communication also must occur in a broader sense, flowing down, across, and up the organization. All personnel must receive from top management a clear message that control responsibilities must be taken seriously. All personnel must understand their own role in the management control system, as well as how individual activities relate to the work of others. Staff members must have a means of communicating significant information upstream. Effective communication is also essential with external parties, such as customers, suppliers, regulators, and shareholders.

5.   *Monitoring* - Management control systems and internal control activities need to be monitored, assessing the quality of their performance over time. Assessment is accomplished through ongoing monitoring activities, separate evaluations, or a combination of the two. Ongoing monitoring occurs in the course of operations, including regular management and supervisory activities and other actions personnel take in performing their duties. The scope and frequency of separate evaluations will depend primarily on an assessment of risks and the

effectiveness of ongoing monitoring procedures. Internal control deficiencies should be reported upstream, with serious matters reported to top management and to the board.

WHO IMPLEMENTS INTERNAL CONTROL?

The Governor

The overall executive responsibility rests with the Governor. **In Idaho, the Governor relies on the State Controller to establish a statewide management control system, with its pertinent internal control policies.** The State Controller sets the tone for a positive control environment and sets the implementation example for the rest of the State entity. He adapts the management control system for achieving the objectives in his own office, as well as for the entire state.

Agency Director

Each agency director (including constitutional officers) is responsible for adhering to the statewide internal control policies and adapting the management control system for achievement of the objectives of his or her agency, to ensure a positive control environment and to convey high ethical standards to division managers. Among other responsibilities, the agency director does the following:
- sets objectives for the agency
- establishes the agency's Strategic Plan
- establishes broad-based agency policies
- establishes the organizational structure
- defines the content of operations
- communicates key policies to staff members
- defines the type of planning and reporting systems the agency will implement
- analyzes risk
- decides how changes will be managed
- monitors the agency

Division Manager

Division managers are responsible for aligning agency policy with division objectives. Division objectives guide the development and implementation of internal control policies and procedures and ensure consistency with the management control system, overall agency objectives, and the strategic plan. In addition, managers provide direction on the following:
- division structure
- personnel hiring and training
- budget information systems
- assessing risk
- deciding how change will be managed
- monitoring the division

Division managers assign specific responsibility for internal control to bureau chiefs and program administrators who have a hands-on role in devising and executing internal control policies within the management control system.

Fiscal Officer

Fiscal officers play a particularly significant role in the implementation of financial internal controls. They track and analyze agency performance from a financial perspective. Fiscal officers are important in preventing and detecting fraudulent reporting. According to the 1992 Treadway Commission, fiscal officers have the following responsibilities:
- to help set the tone of ethical conduct
- to design, implement, and monitor the financial reporting system
- to identify unusual situations caused by fraudulent financial reporting
- to help establish agency financial objectives
- to help analyze financial risk

Staff

Internal control activities are explicit or implicit in the duties of every staff member, including the following:
- delivering services to the public
- producing information for the management control system
- maintaining financial information
- inspecting and maintaining physical assets
- investigating and responding to questions from legislators

In addition, each staff member has the responsibility of communicating to higher levels within the agency, regarding the following matters:
- problems in operations
- non-compliance with codes of conduct
- violations of policy
- illegal actions

Each staff member has the responsibility of resisting pressure to participate in improper activities. The management control system needs to include channels outside normal reporting lines, permitting each staff member to report concerns without fear of reprisal.

State Legislature

In the public sector, management is accountable to the General Assembly (State Legislature). For example, through the rules review, budgeting, and auditing processes, the Governor, agency directors, and governing boards are accountable to legislators. Because the State Legislature can reserve its authority in regard to key decisions, such as Senate confirmation of appointees, or the rescission of funds during lean economic times, legislators have their own unique role in setting high-level objectives. In this manner, the State Legislature's oversight plays a pervasive role in the management control system.

Oversight and Governance

For executive branch departments, oversight and governance groups include the Legislative Council, the Division of Financial Management, the Office of the State Treasurer, central administration agencies such as State Purchasing, and the State Controller. These groups set standards and specify procedures for the operation of state programs.

For higher education organizations, the oversight entity is usually a Board of Trustees and may include an audit committee.

Internal Auditors

Within an agency or division, internal auditors have a direct role in examining the adequacy and effectiveness of internal controls within the management control system. They also have a responsibility to recommend improvements. Internal auditors have a difficult line of objectivity to maintain. Although they report to an agency director or governing board, they must also maintain independence if they are to do their jobs effectively. The Standards of Professional Practice established by the Institute of Internal Auditors describe the internal auditor's important role. Internal auditors must review the following:

- reliability and integrity of financial and operating information and the means used to identify, measure, classify, and report such information
- established systems to ensure compliance with policies, plans, procedures, laws, and regulations with potential for significant impact on operations and reports; determining whether the organization is in compliance
- means of safeguarding assets; verifying, as appropriate, the existence of such assets

- operations and programs, to ascertain whether results are consistent with established objectives and goals and whether the operations and programs are being carried out as planned

The dual nature of an internal auditor's role and the scrupulous maintenance of his or her independence require potential conflicts of interest be carefully monitored. At the same time, internal auditors need to recognize their limitations--they do not have primary responsibility for establishing policy or maintaining internal control.

External Parties

Each entity is subject to external requirements, such as the following:
- civil rights statutes
- the Americans with Disabilities Act
- work place safety requirements
- pension rules
- unemployment insurance laws
- worker's compensation laws

External requirements, such as those listed above, provide an impetus for managers to ensure management control systems (including internal control policies) meet statutory and regulatory requirements.

An agency's customers and suppliers also play a role in the management control system. Delays, inferior service, and failure to meet the public's needs must be monitored. Suppliers who deal with an agency or division can provide observations of discrepancies. When fiscal rules requiring prompt payment to vendors are monitored, data is generated for the management control system.

The news media can play an external, sometimes jarring, oversight role. By providing the Governor, legislators, agency directors, and the public with insight into how others perceive state government performance, the media can provide data for the management control system.

Each of the groups and individuals mentioned in this section plays a role in ensuring an adequate management control system. Each provides important information to ensure objectives are being met. Collectively, they implement management control for the state government.

A GLOSSARY OF SELECTED TERMS

Activity-level Evaluation - An evaluation of a specific work process (e.g., a license application process) and its inputs and outputs.

Application Controls - Programmed procedures in application software and related manual procedures, designed to help ensure completeness and accuracy of information processing. Examples include computerized edit checks of input data, numerical sequence checks, and manual procedures to follow up on items listed in exception reports.

Category - One of three groupings of objectives of internal control within the management control system, of control activities, and of controls. The categories are *effectiveness and efficiency of operations; reliability of financial reporting; and compliance with applicable laws and regulations.* The categories overlap, so any one particular objective might fall into more than one category.

Compliance - Conforming with laws, rules, and regulations applicable to an entity.

Component - One of five elements of internal control within a management control system. The components are *control environment; risk assessment; control activities; information and communication;* and *monitoring.*

Computer Controls -
> (1) Controls performed by computer; i.e., controls programmed into computer software (contrast with *Manual Controls*).
> (2) Controls over computer processing of information, consisting of general controls and application controls (both programmed and manual).

Control -
> (1) A noun, used as a subject; e.g., existence of a control--a policy or procedure as a part of internal control. A control can exist within any of the five *components.*
> (2) A noun, used as an object; e.g., to effect control--the result of policies and procedures designed to control; the result may or may not be effective internal control.
> (3) A verb; e.g., to control--to regulate; to establish or implement a policy to effect control.

Criteria - A set of standards against which a management control system can be measured in determining effectiveness. The five internal control components, taken in the context of inherent limitations of internal control, represent criteria for internal control effectiveness for each of the three control categories.

Deficiency - A perceived, potential, or real internal control shortcoming; or an opportunity to strengthen the management control system, to provide a greater likelihood the entity's objectives are achieved.

Design -
>   (1) Intent. As used in the definition of internal control, the management control system design is intended to provide reasonable assurance as to achievement of objectives--when the intent is realized, the system can be deemed effective.
>   (2) Plan--the way a system is supposed to work, contrasted with how it actually works.

Detective Control - A control designed to discover an unintended event or result (contrast with *Preventative Control*).

Effected - Used with a management control system--devised and maintained.

Effective Control -
>   (1) A management control system can be judged effective in each of the three categories respectively, if management (and any other governing body) has reasonable assurance of the following:
>   - they understand the extent to which the entity's operational objectives are being achieved
>   - public funds are being used responsibly
>   - applicable laws and regulations are being complied with
>
>   (2) A state or condition of internal control within the management control system.

Effective Management Control System - A synonym for *Effective Control.*

Entity - An organization of any size, established for a particular purpose. An entity may be, for example, an agency, a division, a department, or a work unit. In higher education, an entity may be a college, a department, or an administrative unit.

Entity-level Evaluation - An evaluation of an organization, based at least in part on conclusions drawn from *activity-level evaluations.*

Ethical Values - Moral criteria enabling a decision maker to determine an appropriate course of behavior. These values should be based on what is "right," and may go beyond what is "legal."

Financial Reporting - Used with "objectives" or "controls"--having to do with reliability of published financial statements.

General Controls - Policies and procedures to help ensure the continued proper operation of computer information systems. General controls include controls over data center operations, system software acquisition and maintenance, access security, and application system development and maintenance. General controls also support the functioning of programmed application controls. Other terms sometimes used to describe general controls are *general computer controls* and *information technology controls.*

Inherent Limitations - Limitations applicable to all internal controls within a management control system. The limitations of human judgement; resource constraints and the need to consider the cost of controls in relation to expected benefits; the reality that breakdowns can occur; and the possibilities of management override and of collusion.

Integrity - The quality or state of being of sound moral principle; uprightness, honesty, and sincerity; the desire to do the "right" thing; and to profess and live up to a set of values and expectations.

Internal Control - An integral process in the management control system, effected by an entity's management, governing boards, and other personnel; designed to provide reasonable assurance regarding achievement of objectives in the following categories:
- effectiveness and efficiency of operations
- reliability of financial reporting
- compliance with applicable laws and regulations

Internal Control System - A synonym for *Internal Control.*

Management Control System - A set of policies, procedures, and management philosophies, designed to assist management in achieving the strategic objectives of its particular organization or entity. When a management control system satisfies specific criteria in achieving strategic objectives, it can be deemed effective.

Management Controls - Controls performed by one or more managers at any level in an organization.

Management Intervention - Management's actions to overrule prescribed policies or procedures for legitimate purposes. Management intervention is usually necessary to deal with non-recurring and non-standard transactions or events that otherwise might be handled inappropriately by the system (contrast with *Management Override*).

Management Override - Management's overruling of prescribed policies or procedures for illegitimate purposes, with the intent of personal gain or to enhance

presentation of an entity's financial condition or compliance status (contrast with *Management Intervention*).

Management Process - The series of actions taken by management to run an entity. A management control system is a part of and integrated with the management process.

Manual Controls - Controls performed manually, rather than by computer [contrast with *Computer Controls(1)*]**.**

Operations - Used with *objectives* or *controls*--having to do with the effectiveness and efficiency of an entity's programs or activities.

Policy - Management's directive as to what should be done to effect control. A policy serves as the basis for procedures for its implementation.

Preventative Control - A control designed to avoid an unintended event or result (contrast with *Detective Control*).

Procedure - An action to implement a policy.

Process - A series of logically related tasks, involving people, machines, and methods; used to change materials, resources, or data (input) into a specified product or service (output).

Published Financial Statements - Financial statements, interim and condensed financial statements, and selected data derived from such statements (such as monthly budgetary status reports), reported publicly.

Reasonable Assurance - The concept that internal control, no matter how well designed and operated, cannot guarantee an entity's objectives will be met--because *inherent limitations* exist in <u>all</u> management control systems.

Reliability of Financial Reporting - Used in the context of published financial statements, reliability is defined as the preparation of financial statements fairly presented in conformity with generally accepted (or other relevant and appropriate) accounting principles and regulatory requirements for external purpose, within the context of materiality. Supporting fair presentation are the five basic financial statement assertions, as follows:

- existence or occurrence
- completeness
- rights and obligations
- valuation or allocation
- presentation and disclosure

When applied to interim or condensed financial statements or to selected data derived from such statements, both the *factors representing fair presentation* and the *assertions* apply only to the extent they are relevant to the presentation.

Reportable Conditions - An internal control deficiency related to financial reporting-- a significant deficiency in the design or operation of the internal control system. The deficiency could adversely affect the entity's ability to record, process, summarize, and report financial data consistent with the management's *assertions* in the financial statements**.**

Work Process - A synonym for *Process.*

COMPONENT I: CONTROL ENVIRONMENT

Overview

A number of factors are involved in establishing a *control environment*. They include management's attitude and style in the following areas:
- integrity and ethical values
- commitment to competence
- relationship to its governing bodies (such as the State Legislature, governing boards, etc.)
- philosophy and operating style
- organizational structure
- assignment of authority and responsibility
- human resource policies and practices

The goal of an effective control environment is to promote teamwork among competent, cost-conscious workers, with integrity and shared organization values and attitudes.

An organization's control environment has a significant effect on the following:
- how objectives are established
- how risks are assessed
- which control activities are implemented
- how information is communicated
- how the monitoring system works

No two control environments will be exactly the same. Senior management styles differ, as does the autonomy of agencies. A control environment cannot be better than the integrity and ethical values of the people who create and administer it. An ineffective control environment can result in a tarnished public image and in financial loss.

Integrity and Ethical Values

The Governor and agency directors set the ethical "tone at the top." Although policies state what management *wants* to occur, the culture of the organization determines what *actually* happens--which rules are obeyed and which are bent or ignored. The way in which senior management communicates and reinforces its values is critical.

Every organization provides both incentives to achieve ethical behavior and temptations to undermine it. When management puts pressure on employees to meet unrealistic performance targets, ethical values are challenged. When employees are expected to do more than resources allow and rewards are dependent on high performance, employees might be led to "fudge" on actual results. Setting realistic performance targets with sound motivational practices reduces stress and provides incentives to report inappropriate activity.

Written codes are useful, but there is no guarantee employees will follow them. Managers best communicate their moral guidance by example.

Implementation Guidelines:

1.	Establish comprehensive written policies or codes of conduct to address the following:
	a.	acceptable business practices
	b.	prevention of conflicts of interest
	c.	procedures for disclosure of potential conflicts
	d.	expected standards of ethical and moral behavior
		i.	to prevent illegal or improper activities
		ii.	to report illegal or improper activities

2.	Establish a plan for implementation of the policies.
	a.	Policies should be distributed to all employees and periodically acknowledged by all employees.
	b.	Employees should understand what behavior is acceptable and unacceptable.
	c.	Employees should know what to do if they encounter unacceptable behavior.
	d.	Provide a clear channel for employees at all levels to communicate with senior management regarding ethical and moral concerns.
		i.	Establish a process for investigating such problems.
		ii.	See that employees understand there are "whistle blower" statutes to protect them from retribution if they call attention to such problems.

3.   Set a "tone at the top" to give moral guidance about what is right and wrong.
       a.   Communicate, by words and by deeds to all members of the organization, management's commitment to integrity and ethics.
       b.   Employees should feel peer pressure to do the "right" thing.
       c.   Deal with problems, such as customer complaints, slow responses, or high turnover, in a timely and appropriate manner.
       d.   Actively identify potential problems and deal with them, even when the cost of dealing with them could be high.

4.   Establish, and communicate throughout the organization, appropriate steps of remedial action to be taken in response to departures from *statutes, rules, approved policies and procedures, and codes of conduct.*
       a.   See that management responds to violations of behavioral standards.
       b.   Communicate to all employees when disciplinary action is taken as a result of violations.
       c.   Help employees understand violators of behavioral standards will "suffer the consequences," as a matter of policy.

5.   Provide guidance on the type and frequency of situations in which circumvention of, or intervention to, established control policies may occur.
       a.   Explicitly prohibit *management override* of established controls.
       b.   Investigate and document all deviations from established policies.
       c.   Appropriately document and explain all incidents of necessary *management intervention.*

6.   Set realistic performance targets, particularly for short-term results.
       a.   Avoid extreme pressures or temptations which unfairly or unnecessarily test adherence to ethical values.
              i.   Set policy to remove extreme pressures.
              ii.   Establish controls to reduce temptations.
       b.   Base rewards largely on achievement of short-term performance targets.
       c.   Employees need to understand how the larger, long-term issues relate to short-term performance.

Commitment to Competence

Management sets standards for how well tasks should be performed and must then consider the balance between competence and cost. For instance, higher competence requires less supervision, but must be weighed against the higher cost of retaining more experienced personnel. Supervisors analyze what knowledge and skill are needed by employees to perform their jobs adequately. Formal and informal job descriptions assist staff in defining the tasks their particular jobs entail.

Implementation Guidelines:

1.   Establish formal, written job descriptions to define tasks comprising the jobs/positions within your organization.
        a.   Formally analyze the tasks comprising the job.
        b.   Consider the extent to which individuals must exercise judgement.
        c.   Consider the extent of supervision needed.
        d.   Formally analyze and document the knowledge and skills needed by individuals to perform the job.
        e.   Adhere to state personnel rules for hiring, performance evaluation, discipline, and compensation.
                i.   Exempt agencies should adhere to these rules, unless good sound business reasons call for variation in a specific situation.
                ii.   Document and fully explain any variation from the Idaho Personnel Commission's rules.

2.   Evaluate the knowledge and skill exhibited by employees in performing their jobs.
        a.   Document evidence showing your employees appear to have these skills and knowledge.
        b.   Provide training opportunities for all employees, as necessary, to update and increase their knowledge and skills.

Oversight and Governance

The State Legislature plays the role of governing board and the Joint Senate Finance and House Appropriations Committee (JFAC) plays the role of audit committee for the executive branch. Universities and colleges in the State's higher education system also have their own governing boards and audit committees.

Each organization should have an oversight or governing body to which it is accountable. In the private sector, the oversight body is often a board of directors and an audit committee. In Idaho state government, the Governor, the State Legislature (including JFAC), and other citizen boards and committees influence the "tone at the top." How independent the oversight bodies are from agency management influences both the tone and the actual control environment.

The State Legislature and other governing board members need sufficient and timely information to monitor agency management's objectives and strategies, the agency's financial position and operating results, and the terms of significant contractual agreements.

Agency directors, college presidents, and audit committees need to assess the frequency of meetings with program directors and internal auditors. Management needs sufficient and timely information on potentially sensitive issues; including investigations, improper acts, significant litigation, embezzlement or misuse of state assets, and political or illegal payments.

Although the State Legislature and other governing boards need to be involved during the budget process and audit processes, their role is not to micro-manage. All management and staff members need to be sensitive to that distinction.

Implementation Guidelines:

1. Governing board members should have sufficient knowledge, experience, and time to serve the organization's needs effectively.

2. The board must have independence from management, so difficult, probing questions can be raised when necessary.
   a. The board should constructively challenge planned decisions from management, such as strategic initiatives and major transactions.
   b. The board should question and scrutinize activities, present alternative views, and take appropriate action if necessary.

3.   The board should be utilized when a need exists for more in-depth or directed attention to particular matters.
     a.   The board should form committees, including an audit committee.
          i.   The audit committee should review annually the scope of activities of internal and external auditors.
     b.   The committees should be sufficient in subject matter expertise and membership, to deal adequately with important issues.

4.   The board should meet privately and regularly with chief financial/accounting officers, internal auditors, and external auditors for the organization, to discuss the following:
     a.   the financial reporting process
     b.   the system of internal control
     c.   any significant comments and recommendations
     d.   the performance of management

5.   The board should be provided sufficient and timely information, so it can properly monitor the following:
     a.   management's objectives and strategies
          i.   the official Strategic Plan
          ii.   major planning initiatives
          iii. customer service goals
     b.   the organization's financial position
          i.   should have regular financial statements
     c.   the organization's operating results
          i.   financial statements
          ii.   program performance results
     d.   terms of significant contracts and agreements

6.   Establish a process for timely communication to the board of sufficient and timely facts concerning sensitive information, investigations, and improper acts, including the following:
     a.   misuse of travel expenses by senior management
     b.   significant litigation
     c.   embezzlement or misuse of state assets
     d.   illegal or improper payments
     e.   illegal or improper activities

7.   The board should have oversight in determining appointment, compensation, and termination of executive officers.

8.   The board should be significantly involved in establishing the ethical "tone at the top."

a. The board should evaluate management's "tone" and take steps to ensure an appropriate "tone at the top."
b. The board should specifically address management's adherence to the code of conduct.

9. The board should establish procedures for taking action in the following matters:
a. as a result of special investigations
b. issuing directives to management detailing specific actions to be taken
c. to follow up on and oversee actions on directives previously given

Management Philosophy and Operating Style

The individual management styles of the Governor and agency directors will determine what kinds of risks will be acceptable within an agency. Their past histories with successful or dangerous outcomes will influence the levels of risk they will assume and the levels of internal control they will require. However, even the best management control system cannot change an inherently poor manager into a good one.

An informal management style might allow face-to-face interaction rather than written policies. An agency's functional responsibilities will also dictate the appropriate level of internal control; for example, the Department of Revenue and Taxation, the State Treasurer, and the State Controller need more extensive financial reporting controls than does the Department of Employment's Bureau of Research & Analysis or the Idaho Personnel Commission's Bureau of Classification and Test Development.

Implementation Guidelines:

1. Establish goals and policies to help achieve low personnel turnover in the following key functions:
   a. operations
   b. accounting
   c. data processing
   d. internal audit
   e. all management and supervisory positions

2. Establish procedures for periodic analysis of employee turnover patterns, particularly among key financial or internal audit staff, to identify any correlation with the emphasis you place on control.

3. Establish procedures for analysis of management's attitude toward the accounting function, the reliability of financial reporting, and the safeguarding of assets.
   a. Accounting should be viewed as a vehicle for exercising control of the organization's activities.
   b. Management should sign off on accounting reports of results.
   c. Unit accounting personnel should also have responsibility to central financial officers.
   d. Valuable assets, including intellectual assets and information, should be protected from unauthorized access or use.
   e. Establish a cash-management plan for regular reconciliation of cash received to cash deposited.
   f. Keep key staff aware of agency and state fiscal policies and fiscal policy changes.

4. Establish a quality management initiative in your agency.
    a. A quality management plan should have specific goals.
    b. All employees should be familiar with the plan.
    c. Employees should be trained to work in teams to solve problems and to improve work systems.
    d. Management should provide leadership in the quality initiative.
    e. Work processes should be geared to specific customer needs.

5. Communication systems and procedures should be provided to allow for frequent interaction between senior management and operating management.
    a. Managers operating from geographically removed locations should be included.
    b. Senior management should frequently visit decentralized operational sites.
    c. Group or divisional management meetings should be held frequently.
    d. Decentralized managers should visit central offices often enough to keep a broad organizational perspective.

6. Analyze and identify senior management attitudes and actions toward financial reporting and disputes over accounting treatments, such as the following:
    a. conservative vs. liberal accounting policies
    b. whether or not accounting principles have been applied
        i.   don't ignore signs of inappropriate practices
        ii. be wary of estimates that "stretch the facts"
    c. non-disclosure of important financial information
    d. manipulated or falsified records

REMEMBER, THE TONE IS SET AT THE TOP!

Organizational Structure

Because an agency's organizational structure provides the framework for planning and implementing objectives and maintaining internal control, each agency needs to establish a structure appropriate for its mission. Agency heads need to define key areas of authority and responsibility and establish appropriate lines of reporting. The larger the organization, the more highly structured and formal its reporting lines will be. On the other hand, such formality, carried to excess, might impede the flow of information, particularly in the smaller organizations.

Regardless of the organizational structure, internal auditors need direct access to senior management, with sufficient authority to ensure adequate audit coverage and follow-up. The Governor's Chief of Staff or the State Controller's Controller could also be a source of support for internal auditors, if necessary.

Implementation Guidelines:

1.   Establish an appropriate, smooth flowing organizational structure.
    a.   The flow of work must facilitate management.
    b.   Decentralize as much as possible.
    c.   Centralize only as much as necessary.
    d.   Direct the flow of activities as appropriate--upstream, downstream, or across all program activities.
    e.   Adjust the span of control for supervisors to an appropriate size for the supervisor, the activity, and the organization.

2.   Provide key managers with adequate, written, and understandable definitions of their responsibilities.
    a.   Clearly communicate responsibilities and expectations of program activities to the managers in charge of those activities.
    b.   Provide an organizational overview to managers at all levels, so they understand how their program activities tie into the goals and objectives of the entire organization.

3.   Periodically review the knowledge and experience of key managers, as respects their specific responsibilities.
    a.   Ascertain whether managers have the required experience, knowledge, and training to fulfill their responsibilities.
    b.   Encourage managers to update their management skills as their responsibilities change.

4.   Establish and maintain appropriate reporting relationships in the organization.
    a.   Analyze the need for dual or direct reporting relationships.

b. Monitor the effectiveness of existing relationships.
   i. Good reporting relationships provide managers with guidance appropriate to their responsibilities and authority.
c. Provide managers and supervisors with access to senior management.

5. Periodically review and modify the organizational structure to match changing conditions. The organizational environment can be affected by changes in all the following areas:
   a. political
   b. regulatory
   c. statutory
   d. economic
   e. technological
   f. demographic

6. Ascertain whether the organizational structure has sufficient numbers of employees in management and supervisory roles.
   a. Managers and supervisors must have sufficient time to effectively carry out their responsibilities.
   b. Non-classified employees should not be allowed to work excessive hours and should never be asked to fulfill the responsibilities of more than one employee.
   c. Establish controls to ensure non-exempt employees work only as permitted under the Fair Labor Standards Act guidelines.

Assignment of Authority and Responsibility

The control environment is greatly affected when individuals recognize they will be held accountable for their performance. Within the requirements of the state personnel system, heads of organizations need to evaluate how the assignment of authority and responsibility affects employees' initiative and their ability to achieve agency objectives.

The trend toward greater delegation of authority means empowering individuals closest to everyday business decisions. For example, the marketing requirements of the State Lottery demand its staff have greater flexibility to make quick decisions. Such increased delegation may require higher employee competency and presupposes effective, but different, monitoring.

Implementation Guidelines:

1.   Make assignments for responsibility and authority in the organization to create or assign the following:
    a.   organizational goals and objectives
    b.   operating functions
    c.   regulatory requirements
    d.   information systems
    e.   authorizations for changes

2.   Authority and responsibility should be explicitly assigned to employees throughout the organization.
    a.   Responsibility for decisions should be related to and commensurate with the delegation of authority.

3.   Establish appropriate control-related standards and procedures and include them in job descriptions for applicable positions.
    a.   Keep job descriptions current for all personnel.
    b.   Amend control-related responsibilities, as they change, in the job descriptions.

4.   Periodically review the size of the organization's staff in view of the following factors:
    a.   appropriate number with requisite skills in relationship to complexity of activities and systems
    b.   adequacy of work force, in numbers and experience, to carry out the mission of the organization

Human Resource Policies and Practices

Through human resource polices and practices, management communicates its expected levels of integrity, ethical behavior, and competence. Hiring practices, orientation, training, evaluation, counseling, promoting, compensating, and remedial actions all influence the control environment.

Adequate background checks should be done. Policies and procedures for hiring, training, promoting, and compensating must be clearly articulated to employees. Employees should understand and believe retention and promotion criteria. They should also believe performance evaluations will be fairly handled. Appropriate remedial action should always be taken in response to departures from approved policies and procedures. Employees should be well equipped for new challenges in their evolving environments.

The attitude and concern of top management is critical for effective internal control. Mere "lip service" or an attitude of "Do as I say, not as I do" will adversely affect an agency's ability to establish and maintain an effective control environment. Management must consistently "walk its talk."

Implementation Guidelines:

1. If the organization has non-classified employees, establish written policies for hiring, training, promoting, and compensating those employees.
    a. Follow the Idaho Personnel Commission guidelines as appropriate for your organization.
    b. Personnel policies and procedures should result in recruiting or developing competent, trustworthy people who support an effective management control system.
    c. Communicate the organization's expectations about the types of people to be hired and about who should participate in the hiring process.
    d. Establish performance evaluation schedules to at least coincide with promotion and salary increase reviews.
        i. Employees need to know what is expected of them prior to advancement or promotion.
        ii. Evaluation criteria should reflect an adherence to standards of conduct.

2. Establish procedures for making new employees aware of their responsibilities and of your expectations of them.
    a. Employee evaluations should be done at least annually, to make sure employees are kept aware of their responsibilities and of what is expected of them.

     b.   Written communication of employee responsibilities and of management expectations can be included in job descriptions.

3.   Formalize a plan of appropriate remedial action to be taken in response to departures from approved policies and procedures.
     a.   Take appropriate corrective action when established policies are violated.
     b.   Communicate to all employees, so they understand remedial consequences <u>will</u> follow ineffective performance.

4.   Establish a formal procedure for adequate employee-candidate background checks.
     a.   Be cautious of candidates with gaps in employment history or frequent job changes.
     b.   Investigate all criminal records.
     c.   Follow up on reference letters and contact past employers during the selection process.

5.   Establish procedures to ensure compliance with the Idaho Personnel Commission's policies and procedures for classified employees.
     a.   Personnel actions should be performed by, or monitored by, personnel professionals.
     b.   Personnel records must document compliance with required policies and procedures.

COMPONENT II: RISK ASSESSMENT

Overview

Risk affects an agency's ability to survive, to maintain its positive image, and to offer quality services and staff. Since state government cannot operate in a risk-free environment, risks can never be completely eliminated. The way in which an organization establishes its objectives serves as a foundation for risk assessment.

Senior management determines how much risk is prudently acceptable and then strives to maintain that level. An agency's executive director and division managers most often define organizational objectives. Their management styles and the agency's mission will influence whether they use a formal, highly structured objective-setting process, or a more informal one. Some entities will have actual mission statements, while others will rely on value statements or standards which staff strive to achieve. Still others will assess their strengths and weaknesses and this assessment will lead them to an overall strategic plan.

The goal of setting objectives is to develop a broadly stated strategic plan, allocating resources and establishing priorities. Senior management then defines more specific objectives for the various activities of entities within an organization. Senior management also establishes goals to allow the identification of critical success factors. The objectives of all the entities within an organization need to complement one another, while taking into account staff and resource capacities. By the same token, the programmatic objectives of the smallest unit need to be sub-objectives consistent with the organization's overall strategic plan.

Objectives can be divided into the following three categories:
- operations
- financial
- compliance

Operations objectives help staff achieve the agency's basic mission or statutory responsibilities. For instance, when the Department of Agriculture inspects potatoes, it is implementing an operational mission.

Financial objectives set standards to assess management's performance, allocate resources, produce statistics, and protect assets. For instance, when an agency develops its budget for the DFM and JFAC, it is implementing financial objectives.

Compliance objectives include societal obligations as well as operational practices, as defined by federal, state, and local laws, rules, and regulations. For instance, when the

Public Utilities Commission sets telephone rates, it is meeting both its obligation to protect the public interest and its statutory rate-setting responsibilities.

Often objectives overlap--they are not discrete. The example of potato inspections as an operations objective also serves as a compliance objective, because federal law requires the state to inspect food items. When an organization establishes objectives as an entity, senior management needs to be certain those objectives are consistent with capabilities and functions of the individual units comprising the entity. At the same time, when these individual units implement specific activity-level objectives, they must readily understand what is expected of them. They also need to understand their specific activities must be consistent with organizational objectives.

When senior management sets entity-wide objectives differing from past performance, they must examine the linkages between those new objectives and current and future agency activities. For example, if the executive branch commits to aggressive affirmative action hiring goals, the Idaho Personnel Commission must translate those goals into planning, recruiting, appraising, and training activities, so agencies can meet the new performance standards.

Achievement of Objectives

Once objectives are set, management needs to provide measurable targets toward which the agency moves in carrying out its statutory activities. Staff at every level need to be clear about what is to be accomplished. Although all objectives may not be reached, management needs reasonable assurance objectives will be met for operations, for financial information, and for compliance issues.

Even though key purposes of a management control system are to develop clear goals and objectives throughout state government, to identify key success factors and to provide timely performance reports to management, all these cannot absolutely ensure success. A management control system (and its internal control policies) can at best provide only *reasonable assurance* goals and objectives are being met.

Entity-wide Objectives

Implementation Guidelines:

1. Establish entity-wide objectives specific enough for your organization, but sufficiently broad enough to address the following objectives:
    a. as necessary to fulfill major statutory responsibilities
    b. as necessary to achieve organization's desired results

2. Periodically evaluate and update established objectives.

3. Communicate entity-wide objectives to all involved in the process of achieving those objectives, including the following:
    a. all employees of the organization
        i. Obtain feedback from key managers, employees, and others, to determine if communication to employees is effective.
        ii. Evaluate the feedback and adjust objectives as needed.
    b. oversight boards or committees
        i. the State Legislature, if applicable
        ii. the organization's audit committee

4. Link strategic plans to entity-wide objectives.
    a. Strategic plans should support the entity-wide objectives.
    b. Plans should address high-level resource allocations and priorities.
    c. Plans should contain realistic time frames and clearly defined roles and responsibilities.

5. Compare business plans and budget proposals with the following:
    a. entity-wide objectives
        i. Plans and budgets should have appropriate detail for each level of management.
    b. strategic plans
        i. Budgets proposals should be driven by the entity's strategic plan.
    c. current conditions
        i. Plans and budget proposals should reflect your organization's historical experience and current conditions.

Activity-level Objectives

Implementation Guidelines:

1. Establish activity-level objectives, with participation of management at every level within the organization.
   a. Managers should establish activity-level objectives for which they are responsible.
      i. Managers must support the objectives.
      ii. Managers must be committed to achieving the objectives.
   b. Activity-level objectives must be measurable.
      i. Include measurement criteria.
      ii. Measurements should be quantifiable.
   c. Establish a process for reconciling inconsistent objectives.
      i. Objectives should be complementary and reinforcing *within* each activity.
      ii. Objectives should be complementary and reinforcing *between* activities.
   d. Identify resources needed to achieve the activity-level objectives.
      i. Make plans for acquiring necessary resources, such as appropriations, personnel, facilities, and technology.
      ii. Link identified resource needs to the budgeting process.

2. Link activity-level objectives with the entity-wide objectives and strategic plans.
   a. Identify all significant activities and their objectives.
      i. Identify activity-level objectives critical to success of the organization.
      ii. Consider where failure must be avoided to achieve those critical activity-level objectives.
   b. Make sure every identified activity is linked to the entity-wide objectives.
      i. Ascertain budgets are based on relative importance of activity-level objectives.
      ii. Focus your attention on critical factors.
   c. Periodically review activity-level objectives for continued relevance, in light of entity-wide objectives.

Understanding Risks

The process of identifying, analyzing, and managing risk is ongoing. An agency needs a plan to identify both external and internal risks. The plan will help management understand how those risks affect their activities, estimate their significance, manage their effect, and provide continuous monitoring. Risk identification can often be integrated with an organization's planning activities. However, senior management will miss important potential risks if they simply look at the risks identified in the past. Managers need to begin each planning cycle by identifying risks from a clean slate, considering their significance and linking them to organizational activities.

How Risks Arise

Technological developments, changing public expectations, legislative directives, natural catastrophes, and economic changes all have potential for creating *external risks* in state government agencies. Major computer changes affect the way state government operates. Citizens awareness groups bring significant changes in the general public's expectations of government. Natural disasters, like the Teton Dam flood, demand changes in operations and information systems and spark realization of the need for contingency planning. Economic swings cause agencies to look more critically at operations.

Internal risks may be even less predictable. The disruption of the central computer system or of the telephone system causes obvious operational problems. When a new agency director is appointed, changes in management style can affect internal control and compliance objectives. If the executive branch or the State Legislature fail in their oversight responsibilities, opportunities for indiscretion arise.

How Risks Are Identified

Existing systems provide state government managers with important ways to identify risks. The budget process, performance audits, and strategic planning all allow managers to conduct quantitative and qualitative reviews and to prioritize and identify risks. More informal opportunities include senior management planning meetings, meetings with management analysts or internal auditors, and everyday interaction with staff. More important than the specific method used to identify risks is management's careful consideration of the following key factors:
- past experience in failing to meet objectives
- staff quality
- statutory framework
- significance and complexity of activities in relation to agency mission

By analyzing organizational activities, managers apply risk assessment to functions. Successfully managing risk at the activity level contributes to maintaining an acceptable level of risk for the organization.

The Analysis of Risk

Risk analysis involves a careful, rational process of estimating the significance of a risk, assessing the likelihood of its occurrence, and considering what actions and controls need to be taken to manage it. Risk analysis also involves estimating the cost to the agency, if an unexpected risk actually occurs. That analysis is based on the agency's assumptions about the risk and the costs associated with reducing it. Sometimes an actual risk may appear to require one set of actions, but the perceived risk, coupled with media reaction to that risk, requires another more expensive set of actions. For example, the Governor's Office "hires" the DFM to handle all its accounting transactions, to avoid the risk of any perceived impropriety in the Governor's accounting practices.

Recognizing the distinction between risk assessment (a part of a management control system) and actually managing risk (part of an organization's operations) is very important. The budget process can serve as a useful example--developing an agency budget and reporting to JFAC are part of that agency's operations. The financial reports generated throughout the process are part of the management control system and they can help identify potential risks. Limitations on resources will define the level to which risks can be managed.

Implementation Guidelines:

1. Establish a risk identification and risk assessment plan for the entire organization.
    a. Involve the appropriate managers and staff at all activity-levels.
    b. Include methods for identifying risks arising from external sources, including the following:
        i.   economic conditions
        ii.   social conditions
        iii. political conditions
        iv.   external regulation
        v.   natural events
        vi.   potential competitors' actions
        vii. supply sources
        viii. technology changes

    c.   Include methods for identifying risks arising from internal sources, including the following:
- i.   changes in personnel duties (such as the retention of key management personnel or changes in responsibilities which could affect the ability of employees to function effectively)
- ii.   appropriation requests (such as the availability of funds for new initiatives or continuation of key programs)
- iii.   employee relations (such as compensation and benefit programs)
- iv.   information systems (such as adequate backup systems, in case systems fail and significantly affect operations)
- v.   data processing (such as disclosure of data, data integrity, and error, fraud, or misuse of data)
- vi.   cash management activities
- vii.   asset protection and preservation

    d.   Schedule periodic re-evaluations of risk.
- i.   external
- ii.   internal

    e.   Establish risk-analysis processes and guidelines.
- i.   Consider a formal process, to include the following:
  - estimate significance of risk
  - assess likelihood of risk occurring
  - determine needed actions
- ii.   Include informal, day-to-day management activities in the process.

Managing Change

Once risks have been identified and evaluated, management decides on the actions necessary to reduce their potential occurrence and significance and then monitors conditions to remain aware of changing circumstances. Management tools for an early warning system include information systems and ensuring appropriate data are captured, processed, and reported.   An early warning system puts mechanisms in place to identify and communicate events and activities affecting an organization's objectives. Senior management can then analyze the causes of achieving, or failing to achieve, an objective; the likelihood those causes will occur; the probable effect on objectives; and the degree to which a risk can be controlled or an opportunity exploited.

Implementation Guidelines:

1.   Establish plans and procedures for managing change, considering the following suggestions:
   a.   Routine changes can be addressed as part of the normal risk identification and analysis process discussed above, or it can be a separate process.
      i.   Establish ways to anticipate, identify, and react to routine events possibly affecting the ability of the organization to achieve its objectives.
      ii.   Involve managers most responsible for the affected activities.
      iii.   All employees should be encouraged to identify and communicate changing conditions or events.
   b.   Risks and opportunities related to changes should be addressed at sufficiently high levels in the organization to allow for identification of their full implications and for formulation of appropriate action plans.
      i.   All affected activities within the organization should be brought into the review process.

2.   Include mechanisms to identify and react to dramatic changes possibly having a pervasive effect on the organization, demanding attention from top management. Please consider the following:
   a.   changed operating environment
      i.   External information may reveal major shifts in customer needs or public perception.
      ii.   Significant shifts in the work force, externally or internally, could affect available skill levels.
      iii.   New legislation could have dramatic implications on the organization.
   b.   new or redesigned information systems
      i.   The effects of new systems may need to be assessed.

        ii.   Appropriateness of existing control activities should be considered before new computer systems are developed and implemented.

        iii.   Systems development and implementation policies must be adhered to, despite pressures to "shortcut" the process.

        iv.   Consider the effect of new systems on information flow and related controls.

        v.   Consider the effect of new systems on employee training and employee resistance to change.

c.   new personnel

        i.   Take special action to ensure new personnel understand the organizational culture, so they may perform accordingly.

        ii.   Consider key control activities performed by personnel being promoted or transferred.

d.   new services, products, activities, and acquisitions

        i.   Strive to reasonably forecast operating and financial results.

        ii.   Be sure you have adequate information systems and control activities for a new service, product, or activity.

        iii.   Develop plans for recruiting and training people with the requisite expertise to deal with new services or activities.

        iv.   Establish procedures for tracking early results and for modifying processes as needed.

        v.   Monitor the effects on other organizational programs or activities.

e.   organizational restructuring or reductions

        i.   Analyze staff reassignments or reductions for their potential effect on related operations.

        ii.   Reassign the control responsibilities of employees who are transferred or terminated.

        iii.   Consider the impact on the morale of remaining employees after a major downsizing has occurred.

        iv.   Take steps to minimize disruption to essential or continuing services.

        v.   Develop plans for preventing dislocated workers from disrupting service or destroying records.

f.   decentralized operations

        i.   Senior management should keep abreast of the political, regulatory, business, and social cultures of areas where decentralized operations occur.

        ii.   All decentralized operations personnel must be made aware of accepted norms and rules of the central organization.

        iii.   Establish alternative procedures in case activities or communications of decentralized operations are interrupted.

g.   new technology

       i.   Obtain information on technological developments through reporting services, consultants, seminars, or public/private sector alliances.

      ii.   Monitor new technologies and applications.

    iii.   Develop mechanisms for taking advantage of and controlling use of new technology applications and for incorporating them into work processes or information systems.

h.   rapid growth

       i.   Information system capabilities should be upgraded to handle rapidly increasing volumes of information.

      ii.   The work force in operations, in accounting, and in data processing should be expanded as needed, to keep pace with increased volume.

    iii.   Establish procedures and processes for revising budgets and forecasts, as needed.

    iv.   Establish a process for considering inter-departmental implications of revised unit objectives and plans.

Conclusion

Risk assessment can serve management in two directions. Operations improve because risk assessment assumes sound planning and the systematic setting of objectives. Internal control within the management control system is strengthened as activities are evaluated for risk. In the process, an agency is likely to improve its services and its public image.

COMPONENT III: CONTROL ACTIVITIES

Overview

Control activities are actions taken to minimize risk. The need for a control activity is established in the risk assessment process. When the assessment has identified a significant threat to the achievement of an objective, a corresponding control activity should be determined. If control activities are in place for each significant agency operation and if management makes sure those activities are carried out properly, staff can be reasonably confident the management control system will provide the necessary assurances. Control activities include the policies and implementation procedures to help ensure statements of policy are carried out and significant risks are avoided or minimized.

Control activities (such as approvals, authorizations, verifications, reconciliations, reviews of operating performance, security of assets, and segregation of duties) do not further the achievement of organizational program objectives. However, they are the actions taken to help reduce the risks causing those objectives to be not met.

Types of Control Activities

The range of control activities an organization implements hinges on its mission, size, complexity, and degree of risk. When senior management conducts top-level reviews (such as comparing actual performance to budget targets or tracking the progress on new initiatives), it is implementing control activities. When the legislature requests the auditor to conduct a performance audit to identify how departments have implemented their strategic plan, a group of control activities will be set in motion.

Control activities run the gamut from formal to informal. Typically, management first establishes policies to define *what* should be done. In most cases, these policies should be written and available to all employees in a centrally located policies and procedures manual. The policies give direction in formulating procedures detailing *how* the policy will be carried out. The more essential or more difficult procedures should also be documented in writing. Many procedures will be simple and informal in the sense they are verbally communicated and universally understood as "the way we operate."

The review of programmatic performance reports and reconciliations of cash and financial reports are control activities designed to review direct functions or activities. Checking the accuracy, completeness, and authorization of transactions is a control activity associated with information processing. Taking an inventory of equipment or supplies is an example of physical controls. Comparing performance indicators with the strategic plan is another control activity--for example, management may juxtapose program results with financial results and in the process identify unexpected relationships or unusual trends. When supervisors segregate duties to reduce risk of embezzlement or favoritism, they are implementing control activities.

Managers typically use the information they glean from these control activities to make operating decisions. Good managers also follow-up on unexpected results from financial reporting systems, to analyze performance indicators, thereby integrating operational and financial-information control purposes.

Integration With Risk Assessment

Planning reviews and process reviews assist managers in identifying and assessing the risks to achieving their objectives. The actions they take to reduce those risks are actually control activities. The next step in the management of risk is evaluating whether those activities have been carried out properly and in a timely manner. When the Idaho Personnel Commission set an objective of evaluating the equities in the state salary structure, it had to identify a measurement tool. Once the tool was identified, the Commission had to promulgate legislation to enact the indicated necessary changes to the salary administration plan. One risk in achieving its goal was the possibility the

legislature would not approve the plan's changes. The control activity to ensure the achievement of its objective was for the Commission to make "public" its findings, so state employees would take an interest in encouraging management and the legislature to consider the changes. In this way, risk assessment and the implementation of internal control activities become parts of an agency's ability to achieve its objectives and not just ends unto themselves.

Control Over Information Systems

With state government's widespread reliance on electronic information systems comes an increased need for control. *General controls* ensure computer systems will continue to operate properly. The State (Controller's) Auditor's Division of Statewide Accounting and the central computer system operators both effect controls over general operations, including system software operation, access, maintenance, application systems, and development.

Application controls ensure the completeness, accuracy, and validity of information from a particular application or program. The computerized steps within an application and the related manual procedures controlling the processing of various types of actions are part of the control activities an agency establishes. If there are inadequate general controls, the applications may not be dependable. *General controls* are needed to support the functioning of *application controls* and both are needed to ensure the completeness and accuracy of information processing.

Implementation Guidelines:

1.   Develop control activities or technologies to minimize risk.
    a.   Identify significant risk areas and establish control mechanisms to prevent or minimize things going wrong.
    b.   Perform cost/benefit analysis on control mechanisms to ensure they are cost effective.
    c.   Periodically review control activities to determine whether they should be changed.

2.   Establish appropriate written policies and procedures for your organization's key activities.
    a.   Keep policies and procedures manuals current.
    b.   Provide employees with access to those procedures related to their jobs.
    c.   Train new employees in the use of the policies and procedures manuals.

3.   Actively apply identified control activities.

a.   Controls described in the internal control policies manual should be applied to the applicable activity in a correct manner.
b.   Appropriate and timely action should be taken on information or exceptions requiring follow-up.
c.   Supervisory personnel should review the functioning of controls.
d.   Management should periodically review controls to assess whether they are still pertinent.

4.   Please consider some specific control activities for your organization, as suggested in Appendices A and C, at the end of this manual.

COMPONENT IV: INFORMATION and COMMUNICATION

Overview

Pertinent *information* is critical to managing an agency and to an effective management control system. Needed are both financial and non-financial information, relating to both internal and external events. Management needs to identify, capture, and *communicate* information to staff in a timely way, thereby allowing staff to carry out their control responsibilities.

An organization's information systems may capture economic data, the transactions between the organization and its constituents, citizen complaints, and legislative initiatives. Information systems typically provide on-going monitoring functions and response to special needs. An information system may be formal, such as the Department of Health & Welfare's medicaid database; or informal, such as conversations with clients, legislators, or suppliers, and attendance at professional seminars.

The internal control aspect of managing an information system rests with having procedures in place to ensure the consistency and accuracy of data and to ensure a way of integrating changing conditions. An effective system identifies and captures needed data, allowing staff to process the data and report to management in a useful format and in a timely manner. An effective system also gives some indication when conditions are changing, so management can ascertain the necessity of investigating the variances and the need to make adjustments.

Strategic and Integrated Information Systems

An information system supports an agency's operational activities. The challenge is to use technology to help an agency act in a strategic way to advance its overall objectives. The following examples may be relevant to this discussion:

- The Department of Health and Welfare needs an adequate information system to track disease trends.
- The Department of Labor and Industrial Services needs an appropriate system to track trends in the worker's compensation system.
- The Department of Finance needs a reliable system to track early warning signs of distressed financial institutions.
- The Division of Military needs a responsive information system to track citizen concerns about National Guard flight patterns.

Systems, if appropriately designed, can serve state government's strategic need to meet its primary objective. (ie; to improve the quality of life for all Idaho citizens by protecting their health, safety, and welfare to the best of the state's ability)

Although it is imperative to keep up with the burgeoning technological innovations, it is also important to temper enthusiasm enough to be certain new systems co-exist compatibly with current systems. Just because something is new doesn't mean it will provide better service or improved control. Older systems may work more effectively because they have been tried and the "bugs" have been worked out. An evolutionary approach may work best in making new-technology-selection decisions.

The quality of an information system affects management's capacity to make sound decisions in directing both operations and control activities. Control activities involve designing an information system to satisfactorily answer the following questions:

- Is the needed information available?
- Is it timely?
- Are data correct?
- Is the information easily accessible to appropriate people?
- Is the information secured against inappropriate access?

Implementation Guidelines:

1. Establish procedures to provide management with external and internal information needed for evaluation of the organization's performance in relation to established objectives.
   a. Obtain relevant external information on legislative or regulatory developments and on economic and social changes.
   b. Regularly identify and report information useful for evaluating achievement of critical objectives.

    c.   Provide managers information they need to carry out their responsibilities, including the following:
- i.   analytical information to enable managers to develop plans of action
- ii.   information at the right level of detail for the varying levels of management
- iii.   information summaries, backed up with available pertinent facts and smaller details, as needed for further examination
- iv.   timely information, so management can effectively monitor events and activities (internal or external) and react to economic and social factors and control issues

    d.   Develop and revise information systems based on overall strategic plan.
- i.   Link systems to entity-wide objectives.
- ii.   Link systems to activity-level objectives.
- iii.   Consider establishing an information-technology steering committee to identify emerging information needs.
- iv.   Information needs and priorities should be determined by executives with sufficiently broad responsibilities.
- v.   Develop a long-range information-technology plan linked with the strategic objectives.

2.   Make a firm management commitment to supporting the development of necessary information systems.

    a.   Commit appropriate human and financial resources.
- i.   Managers, analysts, or programmers with requisite technical ability need to be available to develop new or enhanced information systems.
- ii.   Employees need to be adequately trained in new or enhanced information systems.
- iii.   Information-systems staff should provide training and support services to other employees, as needed.

Communication

An *information system* provides personnel with data they require to carry out their operating, reporting, and compliance responsibilities. In a broader sense, the information system is a part of an organization's *communication* system. The way management uses the data provided by the system also communicates expectations and responsibilities of individuals and groups within the organization.

A management control system will work if management clearly conveys the message that control responsibilities are to be taken seriously. If staff understand their specific duties and how those activities relate to the work of others, management is using the communication system effectively.

Managers define the means of compatible communication. Open channels of communication and a willingness to listen are important to front-line staff, who also have an important perspective. Normal reporting lines are typically the most appropriate. Yet, separate lines may be needed as a check point, if normal channels fail. A senior manager, the chief internal auditor, an appropriate assistant attorney general, the State Controller's Controller, or the Governor's Chief of Staff can serve this purpose, depending on the seriousness of an issue.

Communication between agencies and legislators is also significant. Legislators need to be up-to-date on performance, developments, risks, and major initiatives. Having better information allows them more effective oversight. A need for balance is important, however, to avoid micro-management.

Senior management will also benefit from the perspectives of people outside state government. Citizens, suppliers, and the media all have important viewpoints that can inform decision makers. The integration of the feedback aspects of quality management initiatives can also aid the internal control process.

Numerous communication methods are available to managers. Policy manuals, memoranda, notices on bulletin boards or in E-mail, and videotaped messages can all serve important roles in varied situations. Meetings provide important communication links where tone of voice and body language play significant roles.

The actions of management are equally important. The way staff members are praised and disciplined is an important aspect of communication. Staff rely on a manager's past history and the culture of the organization in translating communications.

In conclusion, an effective management control system depends on an agency's information system and the way executive directors and other managers communicate. The agency's information system and management's communication style also affect an entity's ability to meet its operational objectives.

Implementation Guidelines:

1.   Establish procedures for effectively communicating to employees their duties and control responsibilities.
      a.   Please consider the following methods:
            i.   formal and informal training sessions
            ii.   employee evaluation meetings
            iii.   on-the-job communication
      b.   Employees should know the objectives of the organization's activities and they should know how their duties contribute to achieving those objectives.
      c.   Employees should understand how their duties affect other employees and how the duties of other employees affect them.
      d.   Employees should understand how their work contributes to larger organization goals.
      e.   Employees should understand the larger process to which their work contributes.

2.   Establish channels of communication for employees to report suspected improprieties, as follows:
      a.   bypassing a direct superior, to communicate with an ombudsman or personnel officer
      b.   respecting anonymity and confidentiality
      c.   making employees feel comfortable using the channels, when necessary
      d.   providing feed back and immunity from reprisal to employees who report suspected improprieties

3.   Establish an employee suggestion process.
      a.   Emphasize quality improvement recommendations.
      b.   Acknowledge good employee suggestions with meaningful rewards and recognition.

4.   Establish procedures for adequate cross-organization (inter-departmental) communication, to enable employees to effectively perform their jobs.
      a.   Give employees sufficient and timely information.
      b.   Share and disseminate central management's internal and external information.
      c.   Hold regular staff meetings.
      d.   Circulate departmental newsletters.
      e.   Disseminate new policies and procedures.
      f.   Routinely communicate changes in legislation.
      g.   Keep staff aware of management activities, including the following:
            i.   long-range objectives

      ii.   organizational changes

      iii.   organizational and staff achievements

5. Establish open and effective channels of communication with customers, suppliers, and other external parties regarding changing customer needs.
   a. Provide channels for feedback among all pertinent parties.
   b. Keep customers and constituencies aware of your organization's services and products.
   c. Advertise your agency's "services" to the target population.
   d. Capture suggestions, complaints, and other input.
      i. Communicate the information to all relevant internal parties.
   e. Report information to the appropriate staff.
      i. Take follow-up action.
      ii. Provide customer feedback.
   f. Make sure employees can identify the customers of their key work processes.
   g. Periodically survey customers to evaluate how their needs and expectations are being met.
      i. Each department should be involved in surveying its own particular "customers."

6. Communicate your organization's ethical standards to customers and constituencies.
   a. Let suppliers, customers, and others know your standards and your expectations regarding their dealings with your organization.
   b. Reinforce your standards by example in routine dealings with external parties.
   c. Report to appropriate personnel improprieties by employees of external parties.

7. Establish policies and procedures to ensure timely and appropriate follow-up on communication received from customers, vendors, regulators, and other external parties.
   a. Present a receptive attitude to reported problems with products, services, and other matters.
      i. Investigate and act on such reports.
   b. Correct errors in customer billings without delay.
      i. Investigate the source of the error.
      ii. Make corrections to avoid repeated errors.
   c. Involve appropriate personnel, independent of those involved in the original transaction, when processing complaints.
   d. Take appropriate action and provide follow-up communication to the original sources.

e.   Provide methods for keeping top management aware of the nature and volume of complaints.

COMPONENT V: MONITORING

Overview

Because internal controls within the management control system change over time, management needs to assess whether the current system is relevant and is able to address existing and new risks. The original circumstances for which the system was designed may no longer exist. Agency staff and legislators may change; there may be time and resource limitations not originally contemplated.

The *monitoring* aspect of internal control activities ensures the system is operating effectively. Monitoring requires appropriate personnel to regularly review the system's design and operation.

On-going Monitoring

An effective management control system is structured to monitor itself on an on-going basis. Monitoring activities are built into normal recurring operational activities. A separate evaluation process may be needed if management believes conditions or risks have changed, or the competence and experience of the staff implementing internal control have been significantly altered. Alternatively, a separate evaluation may be implemented, but because it is after the fact, it may not give an accurate picture of the monitoring process. In fact, most organizations use both on-going monitoring and separate evaluations. Monitoring activities built into the system tend to work more effectively than those added at the end.

Regular management functions such as internal audits, the budget process, and performance evaluations provide on-going monitoring. Good management integrates operating and financial reporting and can, therefore, identify significant inaccuracies or exceptions to anticipated results. The monitoring process also includes an analysis of whether exceptions are reported and resolved quickly.

Examples of external monitoring include an audit by an auditor from the Legislative Services Office, a constituent identifying an inaccurate bill, a citizen's complaint about service, a supplier's questions about prompt payment, and the media questioning an inaccuracy in a state report.

An agency's organizational structure and the way supervisory activities are handled constitute another monitoring function. When data from an information system are checked against physical assets, monitoring occurs. Audit findings serve a monitoring function as do training sessions. An important monitoring activity, one too often overlooked, is to ask personnel explicitly about the organization's code of conduct.

Implementation Guidelines:

1.   Establish policies and procedures to enable management to monitor the reliability of reporting systems.
        a.   Periodically review reports to ensure data are accurate, reliable, and measuring the right things.
        b.   Integrate or reconcile information used to manage operations with data generated by the financial reporting system.
        c.   Require operating personnel to "sign off" on their unit's financial statements.
                i.   Require accuracy and accountability.
                ii.   Require responsibility for errors.

2. Establish policies and procedures to ensure employees obtain evidence the management control system and its integral internal controls are functioning, as they carry out their regular activities.
   a. Provide copies of internal audits and other control system evaluation reports to employees.
   b. Involve employees in the creation and evaluation of management control systems.

3. Establish procedures to monitor the extent to which communications from external parties corroborate internally generated information, or indicate management control problems.
   a. Customers implicitly corroborate billing data by paying their invoices or fees.
      i. Investigate customer complaints about billings or fees when system deficiencies in the invoicing process are indicated.
      ii. Investigate the validity and cause of complaints from regulated entities or benefits recipients.
   b. Use communications from vendors and monthly statements of accounts payable as a control monitoring technique.
      i. Fully investigate suppliers' complaints of unfair practices by purchasing agents.
      ii. Encourage feedback from regulators and central service agencies [State Controller's Office, State Treasurer's Office, Division of Financial Management, etc.], regarding compliance or other matters reflecting on the functioning of your organization's management control system.
      iii. Reassess controls that should have prevented or detected problems.
   c. Be responsive to internal and external auditor recommendations on ways to strengthen internal controls.
      i. Managers with the proper authority should decide which recommendations will be implemented.
      ii. Follow-up on desired actions to verify implementation.
   d. Seek feedback from staff meetings, planning sessions, and other meetings on whether controls are operating effectively.
      i. Capture relevant issues and questions raised at staff meetings.
      ii. Communicate employee suggestions upstream and act upon them, as appropriate.
   e. Actively monitor staff who regularly perform critical activities.
      i. Require employees to sign logs or other evidence they have performed critical control functions (such as reconciling specific amounts).

         ii.   Periodically review critical control activities with the employees responsible for them, to ensure they are still applicable and are working well.

         iii.   Periodically have personnel state whether they understand and comply with codes of conduct.

         iv.   Solicit suggestions from employees for improving or changing control activities.

f.   Periodically review the effectiveness of internal audit activities.

         i.   Appropriate levels of competent and experienced staff are essential.

         ii.   Internal auditors must have appropriately independent positions in the organizational structure.

         iii.   Internal auditors should have access to the senior executive or the governing board.

         iv.   Internal auditors' plans, scope, and responsibilities must be appropriate to the organization's needs.

Separate Evaluations

To perform a separate evaluation, management usually develops a formal evaluation program. The frequency of separate evaluations depends on the significance of the risks for which an organization has control responsibility. The evaluation of the entire management control system, rather than functional parts or specific control areas, is more likely to be prompted by a major change in strategy or a change in management.

An agency's internal auditor typically conducts a separate evaluation of internal control activities. Some entities will make use of checklists, questionnaires, and flowcharts. Auditors may want to compare one agency to another within state government or to an organization outside state government. Integrating the "bench-marking" concepts of the quality management process can be useful in such evaluations.

Implementation Guidelines:

1. Develop a plan for systematic separate evaluations of the management control system.
   a. Include all appropriate portions of the management control system.
      i. The evaluation team should meet together to plan the evaluation process and to ensure a coordinated effort.
      ii. The evaluation process should be conducted by a manager with requisite authority.
   b. Evaluations should be conducted by personnel with requisite skills.
      i. Evaluators must have or gain sufficient understanding of the organization's activities.
      ii. Evaluation methods should include checklists, questionnaires, or other tools.
         • The Management Control System Evaluation Tool Kit (separate manual) provides tools for evaluating the system, including an internal control checklist in Appendix A of that manual.
   c. Ascertain whether evaluations have adequate scope, depth of coverage, and frequency.
      i. You should have an understanding of how the system is *supposed* to work.
      ii. You should gain an understanding of how the system *actually is* working.
   d. Make policy manuals, organizational charts, operating instructions, etc., readily available to the evaluation team.
   e. Document the evaluation process.
   f. Measure the evaluation results against pre-established criteria.

Reporting Strengths and Weaknesses

On-going monitoring and separate evaluations identify "deficiencies" in the management control system. Within this context, a deficiency signifies a condition worthy of attention. A deficiency may outline a weakness, whether the weakness is perceived, potential, or real. Deficiencies provide management an opportunity to strengthen the management control system. Many people or processes can identify deficiencies--staff-generated information, constituent feedback, audit reports, controller reports, the Legislative Services Office budget-analyst review process, DFM reviews, etc. The way senior management embraces these reports affects the success of a management control system as a whole. Deficiencies are reported through normal communication channels. Developing protocols for reporting deficiencies adds value to the management control process.

The key to effective monitoring is appropriate action plans, including follow-up activities. When deficiencies are reported, management needs to evaluate the cost and difficulty of correcting the deficiency against the benefits to be derived. Decisions should be communicated to staff. Monitoring activities assist management in evaluating its management control system in much the same way internal controls within the management control system assist management in having some certainty the structure and procedures are in place to achieve departmental objectives.

Implementation Guidelines:

1.	Develop mechanisms for capturing and reporting identified internal control strengths and weaknesses.
	a.	Formal evaluations by both internal and external parties should be reported to management.
	b.	Findings from ongoing monitoring or separate evaluations should be reported to management.
	c.	Deficiencies should be reported to the person directly responsible for the activity and to a person at least one level higher in the organization.
		i.	Specify the types of deficiencies to be reported to more senior management or the governing board.
	d.	Takes steps to ensure appropriate follow-up actions.
		i.	Ascertain the validity of the identified transaction or event.
		ii.	Investigate the underlying causes of the problem.
		iii.	Follow-up to ensure necessary corrective action is taken.
	e.	Annual reports of your management control system evaluation are to be sent to the State Controller not later than September 30, reporting on the fiscal year ending the previous June 30 (See Appendix B).

APPENDIX A

CONTROL ACTIVITIES (PROCEDURES) TO CONSIDER

Control activities include the policies and implementation procedures needed to help management achieve the organization's specific objectives. The need for control activities is identified during the risk assessment process. Control activities and procedures have various objectives and are applied at various levels of the organization. They may also be integrated into specific components of the control environment and the accounting system. Generally, these activities and procedures may be categorized into one of the following three areas:

I. <u>Segregation of Duties</u> - Proper segregation of duties is a necessary condition for making detailed control procedures effective. Duties should be divided so no one person can control two or more functional responsibilities. The desired result is to reduce the opportunities for any person to be placed in a position to both perpetrate and conceal errors or irregularities in the normal course of his duties. Ideally, no employee will be in a position to be either tempted or accused of inappropriate activity. The following four kinds of functional responsibilities should be performed by <u>different</u> departments, or at least by <u>different</u> persons on the accounting staff:

   A. **Authorization to execute transactions**--Transaction-execution authorization belongs to people having authority and responsibility for initiating record keeping for transactions. Authorization may be general, referring to a class of transactions (e.g. all purchases), or it may be specific (e.g. sale of a major asset).

   B. **Recording transactions**--Transaction recording responsibilities refer to the accounting and record-keeping function, whether done with a manual system or through a computer system. The design and use of adequate documents (such as monitoring prenumbered shipping documents) and records help ensure proper recording of transactions and events.

   C. **Custody of assets and records involved in the transaction**--The custody responsibility refers to the actual physical possession or effective physical control of assets. Physical assets include cash, inventory, supplies, computer programs, computer data files, accounting records, and other "hard" assets of the organization.

D. **Periodic reconciliation of existing assets to recorded amounts**--The reconciliation responsibility refers to making comparisons at regular intervals and taking appropriate actions with respect to any identified differences. Please consider the following:

1. Most reconciliations need to be done monthly.

2. Personnel preparing reconciliations must not be involved in the transaction initiation. For instance, persons making bank reconciliations should never have authority to make bank transfers.

II. <u>Review Procedures</u> - Proper review procedures involve reviewing for the following seven control objectives:

A. **Validity**--refers to controls designed to ensure recorded transactions are those that should have been recorded.

B. **Completeness**--refers to controls designed to ensure valid transactions are not omitted from the accounting records.

C. **Authorization**--refers to controls intended to ensure transactions are approved before they are recorded. The control system should permit accounting to proceed only for authorized transactions and should bar unauthorized transactions.

D. **Accuracy**--refers to controls designed to ensure dollar amounts are figured correctly. Manual and computer checks to validate multiplication and addition of totals, are intended to control accuracy.

E. **Classification**--refers to controls intended to ensure transactions are recorded in the right accounts and charged or credited to the right customers.

F. **Accounting**--is a general category encompassing controls designed to ensure the accounting processes are being followed according to the policies and procedures set by the State Controller.

G. **Proper Period**--means control over accounting for transactions in the period in which they occur.

The seven objectives listed above are all directed towards either preventing, detecting, or correcting the general types of errors, irregularities, and misstatements that can occur.

APPENDIX A

III. **Authorization Controls -** refers to the controls intended to ensure all transactions are properly approved before they are recorded.

    A.   Every organization should maintain a current organizational chart, outlining the lines of authority.

    B.   Maintain lists of individuals authorized to sign or approve transactions, with their signatures and a list of their responsibilities on file.

Control activities and procedures should be considered to ensure the organization is in compliance with the Statewide Fiscal Policies, the Idaho Code, the Board of Examiners' Rulings, and other miscellaneous policies, including the following:

1.   Idaho Travel Regulations

2.   Moving Expense Regulations

3.   Refund and Reimbursement Accounting (rotary & other reimbursements)

4.   Budgetary Accounting

5.   Inter-agency Billing/Payments

6.   Purchasing

8.   Payment of Idaho Sales Tax by State Agencies

9.   Payment of the $0.09 per gallon Federal Excise Tax on gasoline

10.   Encumbrance Guidelines

11.   Warrant Cancellation

12.   Adjustments (expenditure, revenue, and budgetary)

13.   Reports (daily, monthly reconciliations, rotary reconciliations)

APPENDIX A

APPENDIX B

SAMPLE STATEMENT BY THE STATE AGENCY'S CHIEF EXECUTIVE OFFICER CONCERNING COMPLIANCE OF THE STATE AGENCY'S SYSTEM OF FINANCIAL AND ADMINISTRATIVE MANAGEMENT CONTROL SYSTEM WITH STANDARDS SET BY THE STATE CONTROLLER [IDAHO CODE 67-1001 (5)]

DUE BY: September 30

The Honorable J.D. Williams
State Controller
P.O. Box 83720
Boise, ID 83720-0011

For the _____(name of organization)_____ an evaluation of the administrative and financial management control system in effect during the fiscal year ending _June 30, 19XX____ was performed in accordance with guidelines established by the State Controller under the authority of **IDAHO Code 67-1001 (5).**

The objectives of the system of administrative and financial management control system of the _____(name of organization)_____ are to provide reasonable assurance of the following:

1.   Employee duties are segregated as may be necessary to assure the proper safeguarding of state assets.

2.   Restrictions have been effected, limiting access to state assets only by authorized persons in the performance of their assigned duties.

3.   Adequate authorization and record-keeping procedures have been established providing effective control over state assets, liabilities, revenues, and expenditures.

4.   Agency personnel are of the quality and integrity commensurate with their assigned responsibilities.

5.   The agency has implemented an effective process of internal review and adjustment for changes in conditions.

6.   Resources are utilized efficiently, effectively, and in compliance with applicable federal and state laws and regulations.

7.   Obligations and costs are in compliance with applicable federal and state laws and regulations.

8. Funds held outside the State Treasury are managed, used, and obtained in strict accordance with the terms of their enabling authorities and no unauthorized funds exist.

The concept of reasonable assurance recognizes the cost of management control should not exceed the benefits expected to be derived therefrom. The expected benefits consist of reductions in the risks of failing to achieve the stated objectives. Estimates and judgements are required to assess the expected benefits and related costs of control procedures. Furthermore, errors or irregularities may occur and not be detected because of inherent limitations in any system of administrative and financial management control, including those limitations resulting from resource constraints, legislative restrictions, and other factors.

Finally, projection of any evaluation of the system to future periods is subject to the risk procedures may be inadequate because of changes in conditions, or the degree of compliance with the procedures may deteriorate. Nonetheless, I have taken the necessary measures to assure the evaluation, as identified in the first paragraph, has been conducted in a thorough and conscientious manner. **A summary of the evaluation process used is enclosed.**

Statement of Compliance
(Select the appropriate paragraph)

1.The _____ has instituted
      (name of organization)
and maintained systems of administrative and financial management control and is in substantial compliance with the standards set by the State Controller under **IDAHO CODE 67-1001 (5).**

2.The _____ has instituted
      (name of organization)
and maintained systems of administrative and financial management control and does not fully comply with the standards set by the State Controller under **IDAHO CODE 67-1001 (5).** Attachment A to this letter is a summary of material weaknesses. Attachment B is the corrective action plan, outlining a schedule for correcting the weaknesses. A separate corrective action plan is presented for each weakness.

_____   _____
(Signature of the Chief Executive Officer)   (Date)

APPENDIX B

APPENDIX C

SUGGESTED SPECIFIC AREAS FOR STUDY AND EVALUATION OF FINANCIAL ACCOUNTING INTERNAL CONTROLS

This appendix presents an extensive inventory of financial accounting areas frequently requiring specific internal controls.   Although the inventory is extensive, it is not represented as being all-inclusive.   You should also recognize there is little likelihood procedures in <u>all</u> these areas would be desirable in any one state agency.

The inventory is recommended as a guide to state agencies in developing individual agency accounting internal control policies. The suggestions contained in this appendix were compiled from various sources, including the 1986 revision of "Audits of State and Local Governmental Units," by the State and Local Government Committee of the American Institute of Certified Public Accountants (AICPA). **Therefore, the control procedures suggested for study and evaluation are likely to approximate control procedures external and internal auditors will expect to find in applicable situations.**

I.   BUDGETS AND PLANNING

      A.   SEGREGATION OF DUTIES

            1.   Segregate responsibilities for budget preparation, adoption, execution, and reporting.

      B.   PROCEDURAL CONTROLS

            1.   Preparation:
                a.   Be aware of budgets and budgetary procedures required by law.
                b.   Prepare budgets for all <u>significant </u>activities regardless of whether mandated by law.
                c.   Prepare budget calendar to facilitate orderly submission and approval of the budget.
                d.   Develop and prepare initial budget submissions--by major departments and activity centers.

e. Review departmental budgets (by the finance or budget officer), correct oversights by departments, and integrate the executive's goals and objectives.

f. Prepare the budget in sufficient detail to provide a meaningful tool with which to monitor subsequent performance (as established by the Strategic Plan).

g. Budget inter-fund and inter-departmental transfers, if appropriate.

2. Adoption:

a. Hold budget hearings to obtain citizen input, if appropriate.

b. Submit the budget through proper channels to the applicable legislative body for approval.

c. Clearly communicate to operating departments the effects of legislative budget modification mandates (increases or decreases).

d. Coincident with adoption of the budget, ensure action of the legislature, as appropriate, to:
   - Adopt legislation to implement the raising of budgeted revenues.
   - Initiate expenditure appropriations.

e. Record in the accounting records estimated revenues and appropriations, for later comparison to actual amounts realized or incurred.

f. Record in the accounting system budgets approved by grantors in connection with grant activity.

g. Publish budgets, when required by law.

3. Execution:

a. Formally adopt and communicate procedures establishing authority and responsibility for transfers between budget categories.

b. Use an allotment system to control the flow of expenditures or commitments.

c. Approve availability of funds--by the accounting department, before issuance of a purchase order or expenditure commitment.

d. Process and approve requests for supplemental appropriations or budget changes the same way the original budget is processed and approved (or as required by law).

e. Establish controls to ensure knowledge of outstanding commitments, if liabilities and expenditures are recorded on an encumbrance or obligation basis.

4.   Reporting:
a.   Compare actual expenditures to budget with reasonable (monthly) frequency and on a timely basis.
b.   Discuss reports with departmental personnel, obtaining explanations for significant variations from budget.
c.   Notify both the executive and legislative branches, on a timely basis, of expenditures in excess of appropriations or budget.
d.   Publish comparisons of actual results of operations against the budget.

II.   CASH

A.   SEGREGATION OF DUTIES

1.   Segregate responsibilities for collection and deposit preparation functions from those for recording cash receipts and general ledger entries.

2.   Segregate responsibilities for cash receipts functions from those for cash disbursements.

3.   Segregate responsibilities for disbursement preparation and disbursement approval functions from those for recording or entering cash disbursements information on the general ledger.

4.   Segregate responsibilities for the disbursement approval function from those for the disbursement, voucher preparation, and purchasing functions.

5.   Segregate responsibilities for entries in the cash receipt and disbursement records from those for general ledger entries.

6.   Segregate responsibilities for preparing and approving bank account reconciliations from those for other cash receipt or disbursement functions.

7.   If EDP is used, maintain the principle of segregation of duties within processing activities.

B.   PROCEDURAL CONTROLS

1.   Collections:
a.   Deposit, on a timely basis, all receipts (at least daily for amounts of $200 or more).
b.   In each collection location, establish controls over the collection, timely deposit, and recording of all receipts.
i.   Mail should be opened by two people.
ii.   Remittances by mail should be listed in duplicate at the time the mail is opened.
- Listing should be prepared by a person other than the one opening the mail.
- One copy of the listing should be forwarded to the cashier with the money.
- The other copy should be attached as supporting documentation to the accounting transaction.
- Periodically, a third person should compare the listing with the deposit record.
iii. Amounts of currency contained in each item of mail should be verified by a second person.
iv.   Documents enclosed with currency should be machine date stamped or dated and initialed by the employee opening the mail.
v.   A secure area should be provided for processing and safeguarding cash received.
- Access to the secured area should be restricted to authorized personnel, only.
- The secured area should be locked, when not occupied.
vi.   Cash should be protected by using registers, safes, or locks and should be kept in areas of limited access.
c.   Require separate collection locations to give timely notice of cash receipts to a central accounting department.
- Cash received at branch locations should be transmitted to the central office or to the State Treasurer through the banking system.
- Branch personnel should be restricted to making cash deposits, only.
d.   Compare daily reported receipts from separate collection locations to records in general accounting department.

e. Place a restrictive endorsement on incoming checks as soon as received.

f. Deliver "not sufficient funds" checks to someone independent of personnel processing and recording cash receipts.

g. Establish procedures for follow-up on "not sufficient" checks.

h. Establish controls to ensure checks are returned promptly for deposit, if checks received are forwarded for use as source documents for posting to customers' accounts.

i. Receipts should be controlled by cash register, prenumbered receipts, or other equivalent means, if payments are made in person.

j. Account for receipts and balance them to collections records daily.

k. Account for prenumbered forms, including a record of voided forms.

l. Provide facilities for protecting undeposited cash receipts.

m. Maintain adequate records to assure correct handling and final disposition of items held in suspense.

- Suspense accounting should be eliminated by direct deposit of money to the correct fund, as much as possible.
- However, deposits should not be delayed because fund distribution cannot be immediately determined.

2. Disbursements:

a. Maintain control over warrant, sight draft, or check-signing machines, as to signature plates and usage.

b. Establish procedures providing for immediate notification, as applicable, to banks, State Treasurer, and State Controller, when warrant, sight draft, or check signers leave the unit or are otherwise no longer authorized to sign.

c. Furnish invoices and supporting documents to the signer prior to signing the warrant, sight-draft, or check; to help assure funds are disbursed only for authorized purposes and that laws, rules, and regulations are followed.

d. Set reasonable limits on amounts payable by facsimile signature.

e. Require two signatures on warrants, sight drafts, or checks over a stated amount.

f. Maintain signature plates in the custody of the person whose facsimile signature is on the plate, when the plate is not in use.

     g.   Use plates only under the signer's control and have the signer, or an appropriate designee, record machine readings, to ascertain all signed warrants, sight drafts, or checks are properly accounted for by comparison to document control totals.

     h.   Deliver directly to the mail room signed warrants, sight drafts, or checks, making them inaccessible to persons who requested, prepared, or recorded them.

     i.   Prohibit the drawing of warrants, sight drafts, or checks to "cash" or "bearer."

     j.   Establish controls to ensure all payments are made on a timely basis and in accordance with all purchase orders and contracts.

     k.   Establish controls to ensure duplicate payments are not made.

          i.   Original invoices (no copies) totaling the amount of the disbursement should be attached to each voucher before payment.

     l.   Establish controls to ensure each cash disbursement is properly vouchered and approved by the proper authorities before the disbursement occurs.

3.   Custody:

     a.   Maintain controls over the supply of unused and voided warrants, sight drafts, or checks.

          •   Monthly physical inventories of blank stock should be taken by the custodian and a responsible supervisor.

     b.   Require proper authorization of bank accounts or rotary funds.

     c.   Periodically review and formally reauthorize depositories.

     d.   Establish controls and physical safeguards surrounding petty cash.

     e.   Maintain adequate fidelity insurance coverage.

     f.   Maintain separate bank accounts for each fund, or if not appropriate, adequate fund control over pooled cash.

4.   Detail accounting:

     a.   Establish procedures ensuring collections and disbursements are recorded accurately and promptly in the correct fund or account.

     b.   Establish procedures for authorizing and recording inter-bank and inter-fund transfers and for properly accounting for those transactions.

     5.   General ledger:

          a.   Maintain general ledger control over all bank accounts

          b.   Deliver bank statements and paid warrants, sight drafts, or checks in unopened envelopes directly to the employee preparing the reconciliation.

          c.   Establish procedures essential to an effective reconciliation, particularly considering the following:

- Compare warrants, sight drafts, or checks in appropriate detail with disbursement records.
- Examine signature and endorsements, at least on a test basis.
- Account for numerical sequence of warrants, sight drafts, or checks used.
- Compare book balances used in reconciliations with balances in general ledger accounts.
- Compare deposit amounts and dates with cash receipt entries.
- Foot cash books.

          d.   Review and approve all reconciliations and investigate unusual reconciling items--by an official not responsible for receipts and disbursements, including recording evidence of the review and approval, by signing the reconciliation.

          e.   Periodically investigate checks outstanding for a considerable time.

III.   INVESTMENTS

A.   SEGREGATION OF DUTIES

1.   Segregate responsibilities for initiating, evaluating, and approving transactions from those for detail accounting, general ledger, and other related functions.

2.   Segregate responsibilities for initiating transactions from those for final approvals committing government resources.

3.   Segregate responsibilities for monitoring investment market values and performance from those for investment acquisition.

4.   Segregate responsibilities for maintaining detail accounting records from those for general ledger entries.

5.   Assign custodial responsibilities for securities or other documents evidencing ownership or other rights to an official with no accounting duties.

6.   If EDP is used, maintain the principle of segregation of duties within processing activities.

B.   PROCEDURAL CONTROLS

1.   Approval:
   a.   If applicable, establish procedures adequate to ensure only investments permitted by law are acquired.
   b.   Formally establish and periodically review investment policy guidelines.
   c.   Integrate the investment program with the cash management program and with expenditure requirements.
   d.   Establish authority and responsibility for investment opportunity evaluation and purchase.
   e.   Periodically evaluate the performance of the investment portfolio--by persons independent of investment portfolio management activities.
      •   Also verify all income due from investments has been received.
   f.   Formally establish procedures governing the level and nature of approvals required to purchase or sell an investment.
   g.   Use competitive bidding for certificate-of-deposit purchases.

2.   Custody:
   a.   Establish adequate physical safeguards and custodial procedures over the following:
      •   Negotiable and nonnegotiable securities owned
      •   Legal documents or agreements evidencing ownership or other rights
   b.   Require dual signatures or authorizations to obtain release of securities from safekeeping or to obtain access to the governmental unit's safe deposit box.
   c.   Require and obtain authorization, by the legislative body, of persons with access to securities.
   d.   Register all securities in the name of the governmental unit.
   e.   Periodically inspect or confirm securities in custody of safekeeping agents.
   f.   Bond individuals with access to securities.

3. Detail accounting:
   a. Maintain detail accounting records for investments
      - by the investment department, and
      - by the accounting department.
   b. Establish procedures to ensure transactions arising from investments are properly processed, including income and amortization entries.
   c. Maintain controls to ensure investment earnings are credited to the fund from which resources were provided for the investment.
   d. Periodically compare income received and the amount specified by the terms of the security or from other publicly available investment information.
   e. Establish controls to ensure transactions are recorded on a timely basis.

4. General ledger:
   a. Establish procedures for reconciling the detail accounting records with the general ledger control.
   b. Periodically review nature of investments included in general ledger balances.

IV. REVENUES AND RECEIVABLES

A. SEGREGATION OF DUTIES

1. Segregate the responsibilities for billing for services and fees from collection and accounting.

2. Segregate the responsibilities for maintaining detail accounts receivable records from collections and general ledger posting.

3. Segregate collection, control, credit issuance, and deposit of funds activities from maintaining accounting records.

4. Maintain tax assessment rolls, etc.--by individuals not engaged in any accounting or collection function.

5. Segregate the responsibilities for entries in the cash receipts records from those for general ledger entries.

6. If EDP is used, maintain the principle of segregation of duties within processing activities.

B. PROCEDURAL CONTROLS

1. Sales, income, and other taxes:
   a. Cross-reference returns filed against a database of previous taxpayers.
   b. Organize and integrate the records in a manner so probable taxpayers are identified as a result of reporting other governmental activities, such as licensing.

2. License fees and permits:
   a. If annual payments are involved, establish procedures to ensure previous year's records are properly updated for new registrants and withdrawals.
   b. Use the updated records as the basis for billing persons subject to payment.

3. Fines, forfeitures, and court fees:
   a. Maintain and use court and other records of payments due as a basis for collections.
   b. Establish procedures surrounding the control, issuance, and disposition of fee notices to ensure amounts due are assessed and collected.

4. Enterprise and other service revenues:
   a. Maintain controls to provide assurance customer database and, where appropriate, usage records are accurately maintained to ensure amounts due are billed.

C. BILLING/REMITTANCE VERIFICATION

1. Sales, income, and other taxes:
   a. Review returns for mathematical accuracy.
   b. Correlate current year's taxpayers' returns with prior year's returns and account for and review differences.
   c. Separate review and approval of claims for refund.
   d. Audit returns filed, to provide reasonable assurance taxable income is properly recorded.

2.   License, fees, and permits:
      a.   Compare current year receipts to those for prior years and
            have senior officials review explanations of variation.

3.   Fines, forfeitures, and court fees:
      a.   Establish procedures for correlating amounts collected with
            records of court proceedings.
      b.   Sequentially number and satisfactorily account for all
            fine/fee-assessment documents.

4.   Enterprise and other service revenues:
      a.   If billing is based on usage, perform service readings in a
            timely fashion.
      b.   Periodically rotate service measurement readers.
      c.   Establish billing procedures for identifying and investigating
            unusual patterns of use.

5.   General:
      a.   Promptly bill service fees, taxes, etc.
            •   Independently verify quantities, prices, and clerical
                 accuracy of billing invoices.
      b.   Establish procedures designed for other revenue areas,
            ensuring timely payment of amounts due.
      c.   Periodically review and approve the rates of taxes, fines,
            fees, and services--by the legislative body.
      d.   Require periodic review and approval, from the legislative
            body, of programs of tax exemption or relief.
      e.   Require authorization by the legislative body of utility rate
            schedules, as applicable.
      f.   Establish procedures for timely notification to the accounting
            department when billings or claims are prepared and
            rendered.
      g.   Establish numerical batch-processing controls over billings.
      h.   Establish controls over the billing of miscellaneous
            revenues.
      i.   Establish procedures to prevent interception or alteration by
            unauthorized persons of billings or statements after
            preparation, but before mailing.
      j.   Promptly investigate disputes with billing amounts, reported
            by taxpayers or service recipients--by an individual
            independent of receivables record keeping.
      k.   Establish controls to reasonably assure restricted revenues
            are expended only for restricted purposes.

l.   Establish methods and procedures to protect records of receivables from destruction and unauthorized access.

m.   Require monthly balancing of control accounts with detailed ledgers.

n.   Use prenumbered credit memorandum forms and maintain an accounting for the numbers.

6.   Collection:

a.   Place a restrictive endorsement on incoming checks as soon as received.

b.   Establish procedures to reasonably assure interest and penalties are properly charged on delinquent taxes, fees, or charges for service.

c.   Maintain controls for the collection, timely deposit, and recording of collections in the accounting records at each collection location.

d.   Require timely notice of cash receipts from separate collection centers to general accounting department.

e.   If payments are made in person, use prenumbered receipts for payment; and account for and balance such receipts to collections on a regular basis.

f.   Segregate and make timely remittance of amounts collected on behalf of other governments or other governmental units.

g.   Monitor taxes and fees collected by another governmental unit to assure timely receipt and review amounts received for reasonableness.

h.   Receivable amounts should be aged monthly and reviewed by authorized personnel.

- Review delinquent accounts and take prompt action to collect or consider them for charge-off on a timely basis.
- Write-offs or other reductions of receivables should be formally approved by senior officials not involved in the collection function.
- Procedures should be provided for executing all possible legal remedies to collect charged-off or uncollectible accounts, including tax-sale of property, liens, etc.

7.   Accounts receivable record keeping:

a.   Establish controls in system, to assure individual receivable records are posted only from authorized source documents.

b.   Reconcile the aggregate collections on accounts receivable against postings to individual receivable accounts.

     c.   Where appropriate (for example, in proprietary funds), mail statements of account balance on a timely basis.

     d.   Periodically review receivable accounts for credit balances.

8.   General ledger:

     a.   Regularly prepare trial balances of individual receivable accounts.

     b.   Reconcile trial balances with general ledger control accounts and investigate reconciling items--by someone other than accounts receivable clerks.

     c.   Periodically review aged accounts receivable balances--by supervisory personnel.

     d.   Establish procedures for timely and direct notification to the accounting department of billings and collection activity.

V.   GRANT AND ENTITLEMENT MONITORING

A.   GRANTS

1.   Properly fix responsibility for monitoring grant activities.

2.   Establish a central grants monitoring activity.

3.   Establish procedures to monitor compliance with the following:

     a.   financial reporting requirements

     b.   use of funds and other conditions in accordance with grant terms

     c.   timely billing of amounts due under grants

4.   Account for grant activity so it can be separated from accounting for locally funded activities.

5.   Establish a system for obtaining grantor approval before incurring expenditures in excess of budgeted amounts or for unbudgeted expenditures.

6.   Process grant revenues and disbursements under the same degree of controls applicable to the organization's other transactions (budget, purchasing, etc.).

7.   Include requirements in subgrantee agreements for the subgrantee to comply with primary grant agreement conditions as well as grantee's standards.

8.   Establish reasonable procedures and controls to provide
        assurances of compliance with recipient eligibility requirements
        established by grants.

9.   Establish an indirect cost allocation plan.

10.   Require approval of the plan by all grantor agencies and the DFM.

11.   Establish audit cognizance for rates generated by the plan.

B.   ENTITLEMENT

1.   Compare the amount of funds received with the amount
        anticipated--by a responsible official--and investigate unusual
        variances.

2.   Establish procedures to ensure funds received are spent in
        accordance with legal requirements and spending restrictions.

3.   Review statistical or data reports forming the basis for revenue
        distribution--by a responsible official, before submission.

VI.   CAPITAL ASSETS

A.   SEGREGATION OF DUTIES

1.   Segregate responsibilities for initiating, evaluating, and approving
        capital expenditures, leases, and maintenance or repair projects
        from those for project accounting, property records, and general
        ledger functions.

2.   Segregate responsibilities for initiating capital asset transactions
        from those for final approval, committing government resources.

3.   Segregate responsibilities for the project accounting and property
        records functions from the general ledger function.

4.   Segregate responsibilities for the project accounting and property
        records functions from the custodial function.

5. Assign the responsibilities for the periodic physical inventories of capital assets to responsible officials having no custodial or record keeping responsibilities.

6. If EDP is used, maintain the principle of segregation of duties within processing activities.

B. PROCEDURAL CONTROLS

1. Authorization:
   a. Identify those individuals authorized to initiate capital asset transactions and clearly define their authority.
   b. Establish guidelines with respect to key consideration, such as prices to be paid, acceptable vendors and terms, asset quality standards, and the provision of grants or bonds (if any) financing the expenditures.
   c. Prepare a separate capital projects budget.

2. Executive or legislative approval:
   a. Require written executive or legislative approval for all significant capital asset projects or acquisitions.
   b. Establish procedures for authorizing, approving, and documenting sales or other dispositions of capital assets.
   c. Establish procedures for approving decisions regarding financing alternatives and accounting principles, practices, and methods.
   d. Establish procedures providing for obtaining grantor approval, if required, for the use of grant funds for capital asset acquisitions.
   e. Subject grant-funded acquisitions to the same controls as internally funded acquisitions.
   f. Require supplemental authorizations, including, if appropriate, those of the grantor agency, for expenditures in excess of originally approved amounts.

3. Project accounting:
   a. Engage a qualified employee or independent firm to inspect and monitor technically complex projects.
   b. Establish and maintain projects cost records for capital expenditure and repair projects.
   c. Establish reporting procedures for in-progress and completed projects.

      d.   Establish procedures to identify completed projects, so timely transfers to the appropriate accounting can be made.

      e.   Require review of the accounting distribution to ensure proper allocation of charges to fixed asset and expenditure projects.

      f.   If construction work is performed by contractors, establish procedures to provide for, and maintain control over, construction projects and progress billings.

      g.   Exercise the right to audit contractor records during project performance.

      h.   Perform audits of contractor compliance with Equal Employment Opportunity (EEO), Davis-Bacon (Act), and other regulations and contract terms, in addition to costs.

4.   Asset accountability:

      a.   Maintain detail property records for all significant self-constructed, donated, purchased, or leased assets.

      b.   Establish accountability for each asset.

      c.   Establish procedures for periodic inventory of documents evidencing property rights (ie; deeds, leases, etc.).

      d.   Maintain physical safeguards over assets.

      e.   Establish procedures to ensure purchased materials and services for capital expenditure and repair projects are subjected to the same levels of controls as exist for all other purchases (receiving, approval, checking, etc.).

      f.   Periodically compare detail property records with existing assets.

      g.   Investigate differences between records and physical counts and adjust the records to reflect shortages.

      h.   Establish procedures to ensure capital assets are adequately insured.

      i.   Subject lease transactions to control procedures similar to those required for other capital expenditures.

      j.   Properly identify equipment with numbered tags or other means of positive identification.

      k.   Carry fully depreciated assets in the accounting records as a means of providing accounting control.

      l.   Establish procedures for monitoring the appropriate disposition of property acquired with grant funds.

5.   General ledger:

a. Periodically reconcile the detail property records with the general ledger control accounts.
b. Establish procedures and policies to do the following:
    •   Distinguish between capital projects fund expenditures and operating budget expenditures.
    •   Identify operating budget expenditures to be capitalized in fixed asset fund.
    •   Distinguish between capital and operating leases.
    •   Govern depreciation methods and practices.
c. If costs are expected to be charged against federal grants, establish depreciation policies or methods of computing allowances in accordance with standards outlined in OMB circulars or grantor agency regulations;
    •   if not, adjust depreciation charged to grants accordingly.
d. The accounting records should be adjusted promptly (both the asset and related allowance for depreciation) when items of plant and equipment are retired, sold, or transferred.

VII. PROCUREMENT AND PAYABLES

A. SEGREGATION OF DUTIES

1. Segregate responsibilities for the requisitioning, purchasing, and receiving functions from the invoice processing, accounts payable, and general ledger functions.

2. Segregate responsibilities for the purchasing function from the requisitioning and receiving functions.

3. Segregate responsibilities for the invoice processing and accounts payable functions from the general ledger functions.

4. Segregate responsibilities for the disbursement preparation and disbursement approval functions from those for recording cash disbursements and general ledger entries.

5. Segregate responsibilities for the disbursement approval function from those for the disbursement preparation function.

6. Segregate responsibilities for entries in the cash disbursement records from those for general ledger entries.

7.   If EDP is used, maintain the principle of segregation of duties within processing activities.

B.   PROCEDURAL CONTROLS

1.   Requisitioning:
    a.   Require initiation of purchases of goods and services by properly authorized requisitions bearing the approval of officials designated to authorize requisitions.
    b.   Use and account for prenumbered requisition forms.
    c.   Indicate the appropriation to be charged on the purchase requisition--by the person requesting the purchase.
    d.   Before commitment, from the accounting and budget department, obtain verification sufficient unobligated funds remain under the appropriation to meet the proposed expenditure.
    e.   Have technical specifications accompany requests for special purpose (non-stock items) materials or personal services.

2.   Purchasing:
    a.   Structure purchasing authorizations to give appropriate recognition to the nature and size of purchases and to the experience of purchasing personnel.
    b.   Establish purchase order, contract issuance, and contract approval procedures.
    c.   Periodically review purchase prices--by a responsible employee independent of the purchasing department.
    d.   Use competitive bidding procedures.
    e.   If practical, regularly rotate contract or purchasing officer's areas of responsibility.
    f.   Make provisions in contracts for materials, services, or facilities acquired on other than a fixed-price basis; and provide for an audit of contractor's costs, with payments subject to audit results.
    g.   Establish procedures for public advertisement of non-stock item procurement in accordance with legal requirements.
    h.   Periodically review recurring purchases and review documentation of the justification for informal, rather than competitive bids.
    i.   Establish, document, and distribute policies regarding conflicts of interest and acceptable business practices.

j.   Issue purchase orders and contracts under numerical or some other suitable control.

k.   Obtain an adequate number of price quotations before placing orders not subject to competitive bidding.

l.   Prohibit splitting orders to avoid higher levels of approval.

m.   Require the purchasing department to maintain price lists and other appropriate records of price quotations.

n.   Require the purchasing department to maintain a record of suppliers who have not met quality or other performance standards.

o.   Modify procedures for disbursement of funds under grant or loan agreements and related regulations imposing requirements differing from the organization's normal policies.

p.   Institute procedures to identify, before order entry, costs and expenditures not allowable under grant programs.

q.   Maintain an adequate record of open purchase orders and agreements.

r.   Prohibit or adequately control purchases made for the accommodation of employees.

s.   Consider bid and performance bonds, if construction contracts are to be awarded.

t.   Predetermine selection criteria for awarding personal service or construction contracts and require adequate documentation of the award process.

u.   Subject changes to contracts or purchase orders to the same controls and approvals as the original agreement.

3.   Receiving:

a.   Prepare receiving reports for all purchased goods.

b.   Establish procedures for filing claims against carriers or vendors for shortages or damaged materials.

c.   Take steps to ensure goods received are accurately counted and examined to ensure they meet quality standards.

d.   Maintain a permanent record of material received by the receiving department.

e.   Numerically account for or otherwise control receiving reports to ensure all receipts are reported to the accounting department.

f.   Send copies of receiving reports directly to purchasing, accounting, and (if appropriate) inventory record keeping.

g.　With respect to procurements of special-purpose materials, services, or facilities, assign a government technical representative to monitor and evaluate contractor performance and to approve receipt of services.

h.　If a receiving department is not used, institute adequate procedures to ensure goods for which payment is made have been received; require verification, by someone other than the individual approving payment, goods have been received and they meet quality standards.

4.　Invoice processing:

a.　Establish invoice processing procedures for the following:
- Obtain, directly from issuing departments, copies of purchase orders and receiving reports.
- Compare invoice quantities, prices, and terms with those indicated on purchase order.
- Compare invoice quantities with those indicated on receiving reports.
- As appropriate, check accuracy of calculations.
- Ensure timely payment of invoices, to avail the entity of available discounts.

b.　Receive all invoices from vendors in a central location, such as the accounting department.

c.　Procedures should ensure the accounts payable system is properly accounting for unmatched receiving reports and invoices.

d.　Relate requests for progress payments under long-term contracts to contractors' efforts and formally approve the requests.

e.　Establish procedures for processing invoices not involving materials or supplies (for example, lease or rental payments, utility bills, etc.).

f.　Establish procedures to ensure accurate account distribution of all entries resulting from invoice processing.
- Compare monthly statements with accounts payable balances.
- Reconcile subsidiary ledgers with control accounts monthly.

g.　If applicable, limit access to EDP master vendor file to employees authorized to make changes.

h.　The accounting department should maintain a current list of those authorized to approve expenditures.

i.　Establish procedures for submission and approval of reimbursement to employees for travel and other expenses.

j.   Establish control by the accounting department over invoices received before releasing them for departmental approval and other processing.

k.   Review the distribution of charges in the accounting department--by a person competent to pass on the propriety of the distribution.

l.   Have a senior employee review and approve invoices (vouchers) for completeness of supporting documents and for required clerical checking.

m.   If an invoice is received from a supplier not previously dealt with, take steps to ascertain the supplier actually exists.

n.   Make payments only on the basis of original invoices.

o.   Fix responsibility for ensuring all cash discounts are taken and, if applicable, exemptions from sales, federal excise, and other taxes are claimed.

p.   Refer differences in invoice and purchase order price, terms, shipping arrangements, or quantities to the purchasing department for review and approval.

q.   Have the accounting department record and follow-up on partial deliveries.

r.   Promptly notify the accounting and purchasing departments of returned purchases and correlate such purchases with vendor credit advices.

s.   Review the program and expenditure account to be charged for propriety and budget conformity.

t.   Have check signers or other responsible officials determine restricted revenues are expended only for restricted purposes.

u.   If applicable, establish procedures to ensure adjustment of the reserve for encumbrances, when invoices are prepared for payment.

5.   Disbursements:

a.   Establish procedures for approval of disbursement and signing warrants, sight drafts, and checks.

b.   Maintain control over warrant, sight draft, and check-signing machines, including signature plates and usage.

c.   Establish procedures for immediate notification, as applicable, to banks, State Treasurer, and State Controller, of newly authorized warrant, sight draft, and check signers.

d.   Establish procedures for immediate notification, as applicable, of authorized signers leaving the unit or who are otherwise no longer authorized to sign.

e.   Furnish invoices and supporting documents to the signer prior to signing the warrant, sight-draft, or check.

f.   Set reasonable limits on amounts payable by facsimile signature.

g.   Require two signatures on warrants, sight drafts, or checks over a stated amount.

h.   Maintain signature plates in the custody of the person whose facsimile signature is on the plate, when the plate is not in use.

i.   Use plates only under the signer's control and have machine readings recorded by the signer, or an appropriate designee, to ascertain all signed warrants, sight drafts, and checks are properly accounted for, by comparison to document control totals.

j.   Require cancellation of invoices and supporting documents by or in the presence of the signer at time of signing.

k.   Deliver directly to the mail room all signed warrants, sight drafts, or checks, making them inaccessible to persons who requested, prepared, or recorded them.

l.   Cross-reference warrants, sight drafts, or checks to vouchers.

m.   Control and account for warrants, sight drafts, and checks; and maintain safeguards over all unused and voided negotiable instruments.

n.   Prohibit the drawing of warrants, sight drafts, or checks to "cash" or "bearer."

o.   Establish procedures ensuring signed and issued warrants, sight drafts, and checks are recorded promptly.

6.   Accounts payable encumbrances or obligations:

a.   Regularly compare statements from vendors with recorded amounts payable.

b.   If an encumbrance system is used, reconcile monthly all outstanding purchase orders to the reserve for encumbrances.

c.   Record encumbrance entries based only on approved purchase orders.

d.   Establish procedures to ensure accounts payable and encumbrances are applied against the appropriate account.

e.   Establish procedures to ensure department heads are notified of payments made against accounts payable and encumbrances.

7.   General ledger:

a. Regularly prepare trial balances of reserve for encumbrances and accounts payable.

b. Have an employee, other than the accounts payable clerk, check the footing and test the trial balances to the individual items, as well as compare the total to the general ledger balance.

c. Post transactions between funds, in all affected funds, in the same accounting period and on a timely basis.

8. Grant and entitlement monitoring:

a. Disburse grants only on the basis of approved applications.

b. Define (for example, in regulations) and communicate to grantees, their reporting and compliance requirements

c. Establish procedures to monitor grantee compliance with grant terms.

d. Subject financial operations of grantee to periodic and timely audits.

e. Require sufficiently timely monitoring of recipients, to permit curtailment of any abuse, before completing funds disbursement.

f. Disburse funds to grantees only on an as-needed basis.

g. Establish an appropriate level of grant approval authority.

h. Investigate failure by grantees to meet financial reporting requirements on a timely basis.

i. Require grantees to evidence correction of previously detected deficiencies before approval of an extension or renewal of a grant.

j. Institute entitlement procedures to ensure statistics or data used to allocate funds are accurately accumulated (for example, census bureau forms).

k. Require statements of recipient compliance with entitlement conditions (for example, statement of assurances) to be filed and have a responsible official review them.

l. Review audited financial statements or other compliance requirements of entitlement recipients on a timely basis and investigate all unusual items.

VIII. EMPLOYEE COMPENSATION

A. SEGREGATION OF DUTIES

1.   Segregate responsibilities for supervision and time-keeping functions from personnel, payroll processing disbursement, and general ledger functions.

2.   Segregate responsibilities for the payroll processing function from the general ledger function.

3.   Provide supervision of payroll distribution by employees meeting the following criteria:
       a.   are not responsible for hiring or firing employees
       b.   do not approve time reports
       c.   take no part in payroll preparation

4.   Segregate responsibilities for initiating payments under employee benefit plans from accounting and general ledger functions.

5.   Reconcile the payroll fund or bank account regularly--by employees independent of all other payroll transaction processing activities.

6.   If EDP is used, maintain the principle of segregation of duties in processing activities.

B.   PROCEDURAL CONTROLS

1.   Personnel:
       a.   Properly authorize, approve, and document all changes in employment (additions and terminations), salary and wage rates, and payroll deductions.
       b.   Promptly report notices of additions, separations, and changes in salaries, wages, and deductions to the payroll-processing function.
       c.   Maintain appropriate payroll records for accumulated employee benefits (vacation, pension data, sick leave, etc.).
       d.   Have the personnel department interview terminating employees, as a check on departure and as a final review of any termination settlement.
       e.   Establish and provide written personnel policies.
       f.   Establish controls to ensure payroll costs charged to grants are in compliance with grant agreements.
       g.   Ensure payroll and personnel policies governing compensation are in accordance with the requirements of grant agreements.
       h.   Ensure wages are at or above the federal minimum wage.

    2.   Supervision/time keeping:

       a.   Have the employee's supervisor review and approve all hours worked, overtime hours, and other special benefits.

       b.   Establish time keeping and attendance records and procedures.

       c.   Review for completeness and for the employee's supervisor's approval of time cards or other time reports.

       d.   Ensure time cards, if used, are punched only by the employees to whom they are issued.

       e.   Place the time clock in a position where it can be observed by a supervisor.

       f.   Establish procedures for authorizing, approving, and recording vacations, holidays, and sick leave; and procedures for approving and controlling compensatory time.

    3.   Payroll processing:

       a.   Maintain controls over payroll preparation.

       b.   Require approval and documentation of changes to the EDP master payroll file.

       c.   Limit access to the EDP master payroll file to employees who are authorized to make changes.

       d.   Review and approve completed payroll registers before disbursements are made.

       e.   Review documents supporting employee benefit payments (such as accumulated vacation or sick leave) before disbursements are made.

       f.   Review for reasonableness of comparisons (reconciliations) of gross pay for current to prior period payrolls--by a knowledgeable person not otherwise involved in payroll processing.

       g.   Review the payroll (examination of authorizations for changes noted on reconciliations)--by an employee not involved in its preparations.

       h.   Balance the distribution of dollars and hours of gross pay with payroll registers and require review by someone independent, but knowledgeable of this area.

       i.   Include in the review a comparison to amounts appropriated and budgeted.

       j.   Prohibit payroll advances to officials and employees or subject them to appropriate review.

    4.   Disbursement:

a. Strongly encourage all employees to receive payroll disbursement through "direct deposit" to their bank account.
b. Keep the signature plates and use of the payroll check-signing machines under control of the official whose name appears on the signature plate, or under control of an employee to whom that responsibility has been delegated.
c. Maintain a log to reconcile the counter on the check-signing machine with the number of checks issued in each payroll disbursement.
d. Maintain a separate payroll fund, or an imprest-basis payroll bank account.
e. Regularly reconcile the payroll fund or bank account.
f. Require test comparisons of payroll check endorsements with signatures on file--by someone independent of the payroll department.
g. If payment is made in cash, require signed receipts; and have someone independent of the payroll department compare the signed receipts, on a test basis, with signatures on file.
h. Control the supply of unused payroll checks.
i. Require employees to provide identification before being given checks or pay envelopes.
j. Prohibit employees from accepting another employee's pay.
k. Return unclaimed wages to a custodian independent of the payroll department.
l. Have employees who distribute checks or pay envelopes make a report of unclaimed wages directly to the accounting department.
m. Make payments of unclaimed wages at a later date, only upon presentation of appropriate evidence of employment and upon approval by an officer or employee who is not responsible for payroll preparation or time reporting.
n. W-2 forms should be compared to payroll records and mailed by employees not otherwise involved in the payroll process.
o. Investigate returned W-2 forms.
p. Have internal auditors periodically distribute payroll checks, to ascertain employees exist for all checks prepared.

5. General ledger:
    a. Establish adequate account coding procedures for classification of employee compensation and benefit costs, so such costs are recorded in the proper general ledger account.

      b.   Properly record or disclose accrued liabilities for unpaid employee compensation and benefit costs.

IX.   ELECTRONIC DATA PROCESSING

    A.   SEGREGATION OF DUTIES

        1.   Maintain independence of EDP department from accounting and operating departments for which it processes data.

        2.   Appropriately segregate duties within the data-processing function as follows:
            a.   Systems development (design and programming)
            b.   Technical support (maintenance of systems software)
            c.   Operations

        3.   In smaller and mini-computer installations with limited opportunities for segregation of duties, establish procedures for user departments, as follows:
            a.   Require utilization of batch or other input controls
            b.   Maintain control of master file changes
            c.   Balance master files between processing cycles

        4.   Have the personnel policies of the EDP function include such procedures as reference checks, security statements, rotation of duties, and terminated-employee security measures, to enhance segregation of duties and otherwise improve controls.

    B.   PROCEDURAL CONTROLS

        1.   User controls:
            a.   Establish controls over preparation and approval of input transactions outside the EDP department and controls prohibiting the EDP department from initiating transactions.

b. Have the user exercise control procedures over input, to ensure all approved input is processed correctly through the system (and only once).

c. Establish controls over entry of data in on-line systems to restrict access to terminals and to restrict data entry to authorized employees.

d. Establish on-line systems controls to prevent documents from being keyed into the system more than once and to permit tracing from the computer output to data source and vice versa.

e. Establish controls over changes to master files, such as requiring preparation of specific forms indicating data to be changed, approval by a supervisor in the user department, and verifying against a printout of changes.

f. Establish user controls over rejected transactions through the use of a computerized suspense file of rejected transactions or an auxiliary manual system.

g. Require user-department management reconciliation of output totals to input totals for all data submitted, reconciliation of the overall file balances, and review of outputs for reasonableness.

2. Application Controls:

a. Establish procedures within the data processing control function for proper control of data between the user and the EDP department.

b. Maintain controls over data entry; for example, to include adequate supervision, up-to-date instructions, key verification of important fields, and self-checking digits.

c. Provide program controls over entry of data into on-line systems.

d. Require editing and validation of input data.

e. Establish data processing controls over rejected transactions.

f. Establish controls for balancing transaction and master files.

g. Establish procedures within the data processing control function concerning review and distribution of output.

3. General controls:

a. Maintain controls over changes to system software.

b. Maintain controls over use and retention of tape and disk files, including provision for retention of adequate records to provide backup capabilities.

c.   Maintain controls limiting to authorized employees, access to data processing equipment, tapes, disks, system documentation, and application program documentation.

d.   Use a job accounting system (or console logs) to ensure scheduled programs are processed, proper procedures are followed, and supervisory personnel are assured <u>only</u> required programs have been processed.

e.   Provide supervision of EDP department employees on all shifts.

f.   Document procedures to be followed by computer operators.

g.   Document the data processing system, to provide for continuation of the organization, even if important data processing employees leave.

h.   Establish procedures to protect against a loss of important files, programs, or equipment.

i.   Obtain insurance to cover equipment, programs, and data files.

j.   Require user-approved written specifications for new systems and for modifications to existing application systems.

k.   Establish procedures to test and implement new systems and to test modifications to existing application systems.

X.   FINANCIAL REPORTING

A.   SEGREGATION OF DUTIES

1.   Segregate the final review and approval of financial reports from the responsibility for preparation of the reports.

2.   Segregate the responsibilities for maintaining the general ledger from those for maintaining subsidiary ledgers.

3.   Segregate the responsibilities for maintaining the general ledger from those for custody of assets.

4.   Segregate the journal-entry preparation and approval functions.

5.   Segregate principal accounting, treasury, and custody functions.

6.   If EDP is used, maintain the principle of segregation of duties within processing activities.

B.   PROCEDURAL CONTROLS

1.   General Ledger:
   a.   Establish a formal plan of organization for the unit of government under which reporting responsibilities are clearly defined and reasonably aligned.
   b.   Provide supervision, by a principal accounting officer, over accounting records and accounting employees at all locations.
   c.   Maintain general ledger control over all assets and transactions for all departments of the organization.
   d.   Bond employees in positions of trust in amounts required by statutes or organization policy.
   e.   Establish written accounting policy and procedural manuals, distributed to appropriate personnel.
   f.   Update the accounting policy and procedural manuals, as necessary.
   g.   Establish procedures to ensure only authorized persons can alter or establish a new accounting principle, policy, or procedure to be used by the organization.
   h.   Maintain security for accounting records.
   i.   Establish a formal policy regarding conflicts of interest.
   j.   Require written representations from appropriate personnel as to compliance with accounting policies, accounting procedures, and ethics policies.
   k.   Prohibit loans to officials or employees.
   l.   Periodically evaluate the adequacy and effectiveness of the internal accounting controls related to the organization's transaction systems (procurement, revenues, receivables, etc.).
   m.   Implement measures to correct weaknesses.

2.   Closing:
   a.   Establish procedures and policies for closing the accounts for a reporting period, sufficient to ensure accounts are closed, adjusted, and reviewed on a timely basis.
   b.   Establish procedures to ensure all accounting systems have included all transactions applicable to the reporting period.
   c.   Review and approve valuation reserves or other account balances based on estimates.
   d.   Have all journal entries reviewed, approved, and supported by adequate descriptions or documentation.

      e.   Implement controls to ensure only authorized individuals can initiate entries.

3.   Combining:
   a.   Establish procedures to ensure orderly and effective accumulation of financial data.
   b.   Establish procedures for orderly processing of financial data received from departments and other accounting units.
   c.   Establish procedures to ensure special entries generated in the combining process are recorded and reviewed.

4.   Preparation, review, and approval:
   a.   Establish procedures to ensure financial reports are supported by either underlying account records or other documentation.
   b.   Establish procedures providing reasonable assurances all data required to be included in legal, as well as public reports, are properly disclosed.
   c.   Implement procedures to ensure financial reports are prepared on a consistent basis.
   d.   Review and approve financial reports at appropriate levels of management and, if appropriate, the legislature before public release.
   e.   Establish procedures to ensure all requirements for filing of financial reports are met (senior levels of government, bondholders, public, etc.).